THE POLITICS AND ECONOMICS OF MONETARY POLICY: INTRODUCTION

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Money does not manage itself. But if it does not manage itself, who manages it? The papers in this symposium cite a long history of high-stakes contests for control of the power to create money.

Classical economists — Cantillon and Thornton, among others -- recognized early that monetary mismanagement can inflict painful costs on innocent bystanders, while those seeking power struggle for control. They began a tradition among economists of employing reasoned arguments and evidence to try to persuade governments, or their central-bank agents, to maintain stability in the purchasing power of money. The three authors here adhere to that tradition, while they decry the pervasive, pernicious influence of monetary politics.

Harvey Segal, in "Money Markets Against Governments — Two Centuries of a Spectacular Game," discusses "the struggle between the state, which commandeers resources by virtue of its control over interest." Sometimes, he says, an exceptionally persuasive individual — John Law, for instance — is able to wrest the money power away from government to serve purposes undreamed of by heads of state. In our day, according to Segal, lenders and borrowers in money markets somewhat constrain the power of the Federal Reserve System by anticipating the effects of Federal Reserve actions on prices and interest rates. "The Federal Reserve's move toward targeting money growth in October 1979 is but the latest example of how a government bureaucracy is affected by market forces," he says. Nevertheless, there is a wide gap between vaguely monetarist rhetoric at the central bank and an effective monetarist policy. The contest for control continues.

In "Politics and the Federal Reserve," Robert Auerbach argues that the political independence of the Federal Reserve is fiction. The Federal Reserve is a powerful political entity itself. According to a hypothesis that Auerbach attributes to the late Robert Weintraub, the Federal Reserve, to preserve its own political power, usually carries out the monetary policies of the President of the United States. When it occasionally makes major changes of direction that the President wants, the Federal Reserve, in effect, protects itself from day-to-day interference by the President or Congress. In arguments reminiscent of Henry Thornton, Auerbach says that the Federal Reserve's "short-run knee jerk reactions" to shifting political pressures do great harm to the economic welfare of the U.S.

Auerbach says we need a new system to translate the political premiums

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for long-range price stability and full employment into long-run monetary policy. The Federal Reserve should be part of the Treasury, he says, so that political signals can efficiently be given and presidents would take full responsibility for monetary policy. He further recommends that the Federal Reserve should follow a rule for monetary growth to make its policies predictable. This would limit the discretion of the President as well.

Robert Hetzel depicts an intensely self-protective Federal Reserve in "A Mandate of Price Stability for the Federal Reserve System." With no clear mandate from Congress as to what the Federal Reserve should do, and with no clear social consensus on what the mandate should be, the Federal Reserve System protects itself from external political or other influences by pursuing a variety of goals. It is politically safer for the System to do what looks right for the economic conditions of the moment than to follow long-term courses. Cleaving to long-term targets might at times seem inappropriate to politicians who seek instant relief from whatever is bothering their constituents. Because of lags, however, "monetary policies predicated upon the contemporaneous state of the economy, even though they look right to the public, can destabilize, rather than stabilize the economy."

Hetzel's proposed solution to the problem of controlling money power is to give the Federal Reserve a single goal, a stable-price-level rule. He believes a price-level mandate would shield the Federal Reserve from political pressures to redistribute income and wealth by manipulating interest rates or to finance the government through inflation.

All three authors, writing from widely different perspectives and drawing on a wealth of direct experience, contribute valuable insights on one of the most difficult sets of public policy problems. Their emphasis on the politics of monetary policy should remind us that mastery of technical economics is a necessary, but not a sufficient condition for settling the contest for control of the money power.

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