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Economic Policies in an International Context

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Sometimes it appears that some of the Federal Reserve's critics expect us not only to contribute to solutions to all of the world's economic problems, but to solve the problems simultaneously as well. Some Fed watchers ask us to make a major contribution to balancing the federal budget by promoting very rapid domestic growth and substantially reducing real U.S. interest rates. Others argue that we should aim monetary policy at reducing the foreign exchange value of the dollar, so that the U.S. trade deficit and the associated threat of a trade war will subside. At the same time, of course, we are appropriately expected to live up to our most basic, long-run commitment to make further progress against inflation.

Unfortunately, the laws of economics do not provide monetary policy with the ability simultaneously to make major contributions toward these multiple goals, no matter how desirable. It may be that widespread recognition of the difficulties of attaining multiple

economic goals in a sluggish world economy has stimulated discussion of ways in which economic policies among the major industrial nations can reinforce each other, and such discussions can be helpful. In particular, discussion of somewhat greater coordination of fiscal, monetary, and other policies among the "Group of 10" representatives under the aegis of the International Monetary Fund is a step in the right direction.

Congressional progress in controlling the growth of the spending side of the federal budget is vital, potentially giving flexibility to U.S. monetary policy implementation, and holding out the prospect of possible market-driven declines in real interest rates in this country. In turn, lower rates here could contribute to lower values of the dollar.

Europeans have been frank to suggest that short-term and out-year reductions in the U.S. budget deficit would constitute a milestone on the road to economic policy coordination. It has been further suggested that policies of our trading partners could be adjusted to

contribute to the reduction of international imbalances. Policies which would promote more substantial economic growth abroad could have a place on an international agenda. Reductions in Europe in marginal tax rates (such as those introduced in the United States in 1981, as well as those proposed recently by President Reagan) have the potential to contribute to a revitalization of European economies, with more rapid growth in output and, most importantly, jobs. Somewhat less restrictive policies abroad also could contribute to job creation.

Moderately stronger growth in the economies of our trading partners would help with sticky unemployment and stimulate demand for imports from the United States, thus reducing the U.S. trade deficit and helping to arrest our impetus toward protectionism. Vigorous growth abroad also would provide a larger market for the exports of third world debtor countries.

With Europe's relatively low inflation rates, resistance to more accommodative monetary policies understandably stems from concern that lower real interest rates could weaken domestic currencies and

apply upward pressure on domestic prices. These are legitimate concerns, but they hopefully will be balanced by an awareness of the dangers of continued international imbalances. Moreover, it is not clear that a careful easing of policies by most European countries together would inevitably cause currencies abroad to depreciate in effective exchange rate terms. In addition, the prospects of stronger economic growth in Europe actually could tend to raise demand for investments denominated in those currencies.

The United States economy has grown rapidly by historical standards in its current economic expansion, contributing (along with the strong dollar) to rapid growth in U.S. imports. Unfortunately, our economy has been more sluggish in recent quarters. Partially in response to this slowdown, growth of the monetary aggregates (especially M1) at or above the top brackets of their target ranges most of this year has been tolerated. Moreover, interest rates have been falling for 12 months in this country. Let us review the monetary policies of our trading partners.

A caveat: we cannot lose sight of the greater importance in, say, Canada or the United Kingdom, of international trade flows compared to those in the U.S. economy. Yet recent developments in monetary policies abroad are a legitimate topic in discussions about policy coordination. Last year, monetary authorities abroad generally pursued policies which would seem to support a continued very moderate economic expansion, while further reducing inflation. In each of the countries where authorities set targets for the growth of one or more monetary aggregates, those target ranges were either lowered or left unchanged last year, and the actual growth of monetary aggregates was generally lower than in the previous year. Despite further moderation in inflation rates over the course of 1984, foreign short-term interest rates at the end of last year were on balance little changed from their levels at the beginning of the year.

The overall stance of foreign monetary authorities in 1985 appears to be essentially a continuation of policies aimed at moderate economic growth. In these countries, target ranges for the monetary

aggregates in 1985 have again been lowered or left unchanged, and the actual growth of these aggregates in the early months of this year has in general remained within these ranges.

In West Germany, central bank money last year was slightly below the midpoint of the target range, and the 1985 range for that aggregate has been slightly lowered. However, through April of this year, central bank money has grown near the upper limit of this new target range.

In the United Kingdom, the narrow monetary aggregate grew slightly below the midpoint of its target range for the period just ended, but the broader aggregate grew at or slightly above the upper limit of its range for most of 1984. The recently announced target ranges for the coming fiscal year were lowered by 1 percentage point for both aggregates. Along with changes in the growth of targeted monetary aggregates, significant changes in the pound's foreign exchange value also appear to have contributed to a somewhat tighter stance of monetary policy in the United Kingdom.

The Bank of Canada discontinued the use of a money growth target in November 1982, in large part because of the effects of financial innovation on the Canadian aggregates. Canadian monetary authorities have been guided mainly by interest rate and exchange rate considerations, with particular attention being given to the U.S. dollar/ Canadian dollar exchange rate. Over the past year, Canadian short-term interest rates have followed the same general pattern of U.S. rate movements, although Canadian rates have increased relative to U.S. rates on balance.

Although the Bank of Japan sets short-run projections of monetary growth, these do not play a major role as targets for monetary policy. Short-term interest rates are the primary instruments of policy. By this standard, Japanese monetary policy seems to be following the same pattern as the other countries I have mentioned. Policy seems to have been aimed at trying to support only moderate economic growth without precipitating a weakening of the domestic currency. The strength of the dollar seems to be a main factor against a further easing of monetary policy.

To summarize, a review of the monetary policies of our major trading partners indicates their understandable priority of restraining inflation and maintaining the strength of their currencies, with economic growth also an important consideration. It may be argued that U.S. monetary policy has been somewhat more oriented to sustaining the 1985 expansion, with a watchful eye on inflation. Therefore, speaking for myself, discussion among the "Group of 10" countries concerning policy coordination is a constructive step, and this group seems to be an appropriate forum for such discussions. If the Congress continues to progress in slowing the growth of deficit spending, it could be that coordination will come to mean a greater willingness by the industrial countries to pursue policies that promote moderately faster growth in employment and output by adjustments in fiscal, monetary, and labor market policies, which would contribute to sustaining global economic growth.