Responses to Questions

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1. Coordination of Macroeconomic Policies

The term "policy coordination" has several meanings. One meaning treats policy as governmental action. Increased policy coordination would find countries changing domestic interest rates, tax rates, government spending, or money growth to facilitate adjustment of some other economy. I will call this coordinated action.

A second meaning treats policy as a process leading toward a specified goal. For example, major countries could agree to use monetary policy to achieve price stability. If each adopted a similar process or rule for controlling money to achieve price stability, the policy process would be coordinated. I call this a coordinated monetary policy rule. Bretton Woods, the European Monetary System, or the gold standard are examples of policy rules. Currently, Japan and Germany typically follow a procedure that has many features of a monetary rule. These countries set the growth rate of money on a path that leads to lower inflation (or to maintain price stability) given the average growth of output in the recent past. They announce their objectives for money growth. They achieve these objectives with sufficient frequency to make the announcements credible. Wages, interest rates and prices are influenced by the announcements.

I believe it is not desirable, necessary or feasible to coordinate policy actions, and it is unlikely to happen. It is not necessary because coordinated actions, if carried out, impose more harmonization than is required for reasonable stability. A coordinated monetary policy rule to achieve price stability would provide most of the gains at lower cost.

Coordinated policy action is not feasible for many reasons. I emphasize two. First, democratic governments cannot be expected to act regularly against their perception of their countries interests. A rule will last only as long as it produces outcomes that the public accepts. Coordinated actions by central banks or
governments will rarely be used to inflate, raise taxes, reduce spending, etc. unless it can be justified at home. Second, coordinated action is usually based on forecasts or judgments. Forecast accuracy is too poor to serve as a basis for policy actions that can reduce variability.

Beyond these operational problems, there is the issue of desirability of coordinated actions. I believe that stability is likely to increase if governments concentrate on medium-term strategies that maintain price stability, lower government spending as a share of GDP, reduce the excess burden of government regulation and, in the U.S., remove the bias in the tax system in favor of consumption.

There are benefits from coordination of policies. No country acting alone can achieve both price stability and exchange rate stability. Countries that adopt common policy rules can achieve price stability and exchange rate stability. If the principal countries --- U.S., Japan, and Germany (or the E.C.) --- all adopt policy rules to achieve stable prices, they can also reduce fluctuations in exchange rates arising from differences in expected rates of inflation. The remaining fluctuations in exchange rates will be in response to real changes in a country's relative position, for example its relative productivity growth. An international arrangement of this kind would provide a relatively efficient international monetary system with low inflation, reduced variability of exchange rates, and changes in exchange rates working to adjust economies to changes in tastes, productivity or terms of trade.

Smaller countries would fix their exchange rates to the currencies of one or more of the principal countries. They would obtain exchange rate stability and, if there are no restrictions on trade and capital movements, their domestic prices, especially import prices but others as well, would move with prices abroad. Thus, they would get price stability or low inflation.

Much of the discussion of fluctuating exchange rates assumes that movements of exchange rates are "excessive." This statement is based on misunderstanding. Comparison of exchange rate systems cannot be limited to comparisons of the variability of exchange rates under fixed and fluctuating rates. Exchange rate changes are a substitute for changes in wages, prices, and real variables under fixed exchange
There is no evidence that fluctuating exchange rates uniformly are accompanied by more variability in the economy or greater social cost. The experience of Britain after the return to the gold standard in 1925, the experience of all countries under the gold standard after 1929, the experience of France, Britain, and Italy in the EMS after they committed to rigidly fixed exchange rates in the 1980s suggest some of the social costs of a fixed exchange rate regime.

2. International Credit Markets

The World Bank and regional development banks were set up to supplement private lenders. The presumption was that private lending would be inadequate. This presumption may have been accurate in the 1940s and 1950s when many countries had tight controls on capital movements, domestic credit allocation schemes, and other restrictions on lending. Since that time, conditions have changed.

The debt problems of the 1980s make clear that, at least in the 1970s, the market was eager to supply loans. Many countries accumulated more debt than they could expect to service.

Once heavily indebted countries adopted market-oriented, economic policies, reduced barriers to trade, reduced inflation, etc., private capital -- including equity capital -- became available to the developing countries. This experience has been repeated often, particularly in the last three years.

The emerging system has several features that differ from the earlier system that relied on the World Bank and the development banks. First, more of the capital is equity, not debt. This brings private capital and, with it, often management, technology and other assistance. Second, there is relatively less government-to-government aid. The market has a larger role in allocating capital, although there are still many points at which the state intervenes. Third, there appears to be greater attention to earning returns and less to prestige projects that have often been costly.

The International Monetary Fund (IMF) has lost its original mission. The World Bank's project lending has become less important. The total resources -- current and
prospective -- of these institutions and the development banks are now a small part of international capital available for developing countries that pursue pro-growth policies.

Is there a role for the principal Bretton Woods institutions? I propose that the World Bank and the IMF be merged into a single institution. This institution should have as its principal mission providing information to financial institutions and other lenders about the policies of developing countries. The new institution (call it the Bank Fund) would also offer advice to countries in difficulty. The Bank Fund would not be a lender; its function would be to collect information and certify credit standards -- much as Moody's or Standard and Poor's rates the credit worthiness of domestic firms.

Private borrowers may have greater difficulty getting information about a country's current policies than an international agency that is widely respected by lenders as a certifying agent. The Bank Fund would gather information and issue reports about creditworthiness. Although most lending and investing should be from private suppliers of capital to private demanders, the presence or absence of certification of country policies would be useful information.

A remaining problem is income redistribution. Much lending to the poorest countries has been explicitly, or after the fact, concessional. Many of the poorest countries have not adopted policies that attract private capital. Realistically, this kind of lending is likely to continue. There is no reason why an international agency is needed to dispense these loans. Governments can do it directly. An international agency that kept a record of the flows and outstanding stocks would provide a useful service.

3. The Role of GATT

I believe the GATT should be strengthened in three ways. First, dispute settlement mechanisms should be strengthened. Second, the movement toward trading blocs should be discouraged in favor of more open world trade. Third, eastern and central Europe should be brought within GATT rules.

The Canadian - U.S. free trade agreement allows for settlement of disputes by a commission. Decisions are binding and cannot be overruled by one of the parties.
Thus, the agreement cedes a limited amount of sovereignty to an international body. This principle should be incorporated in the GATT. In addition, there should be a trade court where private parties can sue to enforce GATT rules.

Second, article xxiv of the GATT permits regional trading blocs. Article xxiv should be amended to require that each new trading bloc, or expansion of a trading bloc, requires the members to reduce external tariffs by some fraction of the reduction of internal barriers. This reduction would compensate, in whole or part, for trade diversion.

Third, to encourage and assist the development of market economies in central and eastern Europe, including the former USSR, trade barriers against their exports should be reduced. Trade, not aid, is the best way to help these countries develop.

I share Mr. Neu's concern about the difficulties of defining non-tariff barriers and distinguishing non-tariff barriers from cultural norms. The trading system should not be based on the principle that everyone must have the same standards for health and safety, the same rules, and the same taxes. Agreements cannot specify the content of each and every rule in every country. We do not have such strict comparability in the U.S. Some matters are better left to an international trade court for settlement. We must continue to develop and enforce laws of trade internationally, as we have done domestically.

4. I do not wish to add to my answer to question 2 and 3. Less aid, more open trade eliminates some of these problems. Reliance on private capital instead of government-to-government loans removes others. Greater reliance on markets, and fewer subsidies, returns decisions about development policy to the developing country. A country can choose to meet the market's borrowing requirements or go its own way.

GATT should continue to seek rules that open direct investment and portfolio investment in all member countries.

5. International Regulation

International regulation has been around for centuries. Shipping, airplanes,
insurance, assignment of radio frequencies are examples. There have been many cartels organized by governments to set raw material prices and regulate supply conditions. Experience with government attempts to establish cartels should serve as a warning that international agreements are often anti-competitive agreements.

Nevertheless, there is a case for international agreements about air pollution, pollution of common waterways, responsibility of a country's central bank to serve as lender of last resort for all (national and foreign) domiciled financial institutions, protection of patents and intellectual property and developing enforcement and adjudicatory procedures for the growing body of international law.