

ture. Without some other instrument, the desired growth rate cannot be assured. If, however, investment leads to more growth, then monetary policy and fiscal policy together can be manipulated to achieve the two objectives. The higher the growth rate desired, the lower should be the rate of interest. Fiscal policy can then be adjusted to assure full employment. This very simple model apparently influenced thinking in the early years of the Kennedy Administration.

Viewing economic policy as a problem in specifying targets and finding sufficient instruments to reach them helps to illuminate many policy problems confronting national authorities. The objective of greater economic integration has lead many officials to reject both flexible exchange rates and frequent variations in fixed exchange rates as an instrument for maintaining balance of payments equilibrium. A number of other instruments of policy have been ruled out by international agreement on the same grounds, or to avoid a round of retaliation and counter-retaliation that would leave all countries worse off than they were at the outset. Most types of export subsidies, tariff discrimination among countries, increases in tariffs, and discriminatory exchange regulations fall into this category. A number of provisions of the General Agreement on Tariffs and Trade (GATT) are devoted to these exclusions and prohibitions; with specified exceptions, such as the formation of customs unions or free trade areas, trade discrimination is proscribed.⁸ So are many types of export subsidies and discrimination in domestic taxation between home and foreign goods. The Articles of Agreement of the International Monetary Fund make similar prohibitions with respect to currency arrangements. The extensive use of these measures in the past, especially in the 1930's, led to widespread retaliation and mutual recriminations, and they acquired a bad name among outward-looking officials. But the price of international rules of good behavior as set forth in the GATT and the IMF Articles has been a reduction in the range of instruments available to national policy-makers.⁹

Some usable policy instruments may be used, as a practical matter, only within a limited range. In the United States changes in the discount rate of the Federal Reserve System and (since 1962) deliberate deficits or surpluses in the government budget are both regarded as legitimate tools of economic policy; but in normal times the public is not likely to countenance a discount rate of 20 percent or a budget deficit of \$50 billion. These exceed the range of acceptability; policy instruments have "boundary conditions." In the abnormal situations when such limits become operative, they withdraw an instrument from use. Sometimes these limits are not fully known until they are tested; then we discover that we have more targets (or fewer instruments) than were previously apparent.

It goes without saying that to be attainable economic objectives must be consistent. If they are not consistent, no number of policy instruments will be sufficient. One illustration in the forefront of discussion in most industrial countries involves the relationship between employment and price stability. Given the institution of private collective bargaining, is the target of "full employment" (4 percent unemployment in the United States, under 2 percent in the United Kingdom, each by its own standards and definitions) consistent with "price stability," defined, say, as stability in the consumer price index? Many economists would find a conflict.

This kind of inconsistency can perhaps be overcome by developing new policy instruments.¹⁰ Another kind of inconsistency, especially important to national economies linked through international trade and capital movements, cannot be eliminated through the development of new instruments. Examples are objectives regarding the balance of payments, or the trade balance. Since one country's trade surplus is another country's trade deficit, it is impossible for all countries to succeed in running trade surpluses. The same is true for balance of payments,

⁸ Trade discrimination is also permitted, under Art. XIV of the GATT, when currency discrimination is permitted under the rules of the International Monetary Fund. That occurs if the IMF declares a particular country's currency is "scarce" under its Scarce Currency Clause. No such finding has ever been made, even during the period of severe dollar shortage of the late 1940's.

⁹ Freedom to use some of these instruments may, in any case have been more apparent than real. As noted below, export subsidies in one country raise exports only if other exporting countries do not also use them, or if importing countries do not offset them with higher duties. But that is precisely what happened in the interwar period.

¹⁰ These new instruments would involve shifting the trade-off between unemployment and price inflation—called the Phillips Curve—enough to make simultaneous attainment of the two objectives feasible. This is the thrust of "incomes policies."