

taking into account capital movements.¹¹ If there are n countries, only $n-1$ of them can succeed in achieving their independent balance of payments targets;¹² at least one must accept defeat or else fail to target values for its trade position and its balance of payments position, thereby acting as an international residual. It has been suggested that the United States played this role until the late 1950's, by taking a relatively passive position toward its payments position after the termination of Marshall Plan aid.¹³

The requirement of consistency is not merely theoretical. In 1962, for instance, all of the major industrial countries wanted simultaneously to improve their payments positions on current account. While mutual success was not logically impossible in this case, it did imply a correspondingly sharp deterioration in the current account position of the less developed countries taken together, which in turn would require ample financing from the industrial countries in the form of grants or loans. No such increase in capital movements was targeted. Thus national targets were inconsistent.¹⁴

THE SPEED OF ADJUSTMENT

In summary, successful economic policy requires an adequate number of economic objectives, and it requires that these objectives be consistent with one another. If either of these conditions fails, policymakers are bound to be frustrated in their efforts. Before turning to how these frustrations become manifest, however, one other point should be made: growing interdependence can slow down greatly the process by which independently acting national authorities reach their economic objectives, even when all the targets are consistent and there are sufficient policy instruments at hand to reach them. Thus in practice nations may find themselves further from their objectives than would be true with less interdependence.

High interdependence slows the speed of adjustment to disturbances if national policy-makers do not take the interdependence into account. This is because the economic authorities in different countries may be working at cross purposes. An investment boom in one country may raise interest rates both at home and, by attracting internationally mobile funds, in neighboring countries. The first country may temporarily welcome the high interest rates to help curb the boom and may also tighten fiscal policy to keep inflationary pressures in check. But the other countries may fear that higher interest rates will deter investment at home and take steps to lower interest rates. Unless this monetary relaxation is taken into account in framing fiscal policy in the first country, its authorities will find that fiscal policy has not been sufficiently contractionary. But more contractionary fiscal policy will tend to hold up interest rates, so that the monetary authorities in the neighboring countries will find they have only been partially successful in lowering their rates. Even if in the end the whole process settles to a point where the various national authorities are satisfied, it will have taken longer than if there had been close coordination between the authorities in the several countries involved. The greater the interactions between the countries, the longer convergence will take if countries act on their own.

Sometimes, of course, actions in a neighboring country can reinforce those taken at home. If in the above example the domestic investment boom transmitted inflationary pressures to a neighboring country through enlarged imports, then contractionary fiscal policy there will complement contractionary fiscal policy at home. But in this case failure to take into account the interactions between the two countries may lead to *over-correction* and excessive unemployment. This will arise if the authorities in each country decide how much they have to act when

¹¹ This assumes that national definitions concerning the balance of payments are all consistent, and abstracts from the additional complications created by disparate national definitions of balance of payments "deficit" and "surplus." See Host-Madsen, *Asymmetries Between Balance of Payments Surpluses and Deficits*, IMF, STAFF PAPERS (1962).

¹² Unless, of course, the targets all happen to be consistent, *e.g.*, if the sum of all balance of payments targets happened to add to the annual addition to monetary gold stocks.

¹³ Polak, *International Coordination of Economic Policy*, IMF, STAFF PAPERS 199 (1962). The ability of the United States to take a passive position ended around 1959, when the deficit became very large and foreign officials began to call for correction. One interpretation which can be put on the international discussions to establish machinery for creating international liquidity is that it presents a search for a new residual supplier in the international payments system.

¹⁴ Triffin has underlined the dramatic inconsistencies in balance of payments targets in the early 1960's. See R. TRIFFIN, *THE WORLD MONEY MAZE* 118-32, (1966).