

SOMC POLICY STATEMENT SUMMARY

March 16, 1998

WASHINGTON, DC—The Shadow Open Market Committee today called on the Federal Reserve, the White House and Congress to take concerted action to sustain the nation's economic expansion. The Federal Reserve, the committee said, should take action to "reduce the growth rate of monetary aggregates by reducing growth of the monetary base by two percentage points to an annual rate of 4 percent" from approximately 6 percent at present.

"Current Federal Reserve policy," the SOMC said, "is inconsistent with its stated long-term objectives" of sustainable growth and low inflation. "Money growth rates are higher than at any time since early 1994."

Congress and the Administration, meanwhile, should cut taxes in a way that "increases incentives to save and invest raises income and living standards. This is an excellent way to both raise family income and make future social security payments more secure."

The Shadow Open Market Committee is a group of academic and business economists who comment regularly on public policy issues. The committee was founded in 1973 by the late Professor Karl Brunner of the University of Rochester and Professor Allan H. Meltzer of Carnegie Mellon University, who is chairman.

The SOMC pointed out that total federal "tax collections as a percent of GDP are now at the highest level in U.S. history. It is remarkable that members of Congress who claim to be most concerned about the growing spread in the distribution of income and the sluggish growth of median family income express little interest in tax reduction."

The Committee charged that the Administration's "projections of sustained budget surpluses are illusory and misleading...The President sees "budget surplus as far as the eye can see. He must be shortsighted..."

Estimates by the Congressional Budget Office report the deficit excluding transfers from the trust funds. These estimates do not show surpluses; there are deficits as far as the eye can see... Further when the government borrows from its trust funds, it

is borrowing from itself. It is as misleading for the government as for an individual to talk about budget surpluses under current and prospective conditions.”

The SOMC charged that current lending practices by the International Monetary Fund encourage “moral hazard—a large difference between the risks borne by the debtor country and its citizens and the risks borne by the international bank... Moral hazard will remain as long as the IMF continues to bail out international banks.” Consequently, the SOMC opposed the current proposal for Congress to approve an additional U.S. contribution to the International Monetary Fund. The committee said that “the IMF should be abolished; the Bank for International Settlements should assume the responsibility for lending in the rare instances when such lending is useful.”

The SOMC derided recent forecasts of deflation—a falling price level. Such predictions, it said, “show the low quality of many forecasts and the inchoate arguments based on them... Just as inflation is generated by excess growth of money and aggregate demand relative to productive capacity, deflation—a persistent decline in the general price level—is generated by insufficient growth of money and aggregate demand relative to productive capacity. Deflation will not occur if recent money growth continues.”