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Heft 5

Inflation, Unemployment and Monetary Control

Edited by Karl Brunner and Manfred J. M. Neumann

DUNCKER & HUMBLOT · BERLIN

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Collected Papers from the 1973 - 1976 Konstanz Seminars

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Edited by

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PREFACE

Since 1970 the Konstanz Seminar has offered a European forum for discussion in the field of monetary theory and monetary policy. Scholars from Europe or America and staff members from central banks assemble annually on the (virtual) island of Reichenau near the city of Konstanz in the lake named after the city. For three days every year, the seminar attends to recent developments in monetary theory and important issues of monetary policy.

The current volume is the second publication resulting from the Konstanz Seminar. The first volume contained the papers discussed at the First Konstanz Seminar in 1970. The second volume collects papers from the 1973 - 76 Konstanz Seminars. Most of the papers included here have been published in professional journals. They have been assembled in order to document the range of discussion at this international seminar on the Reichenau.

The volume opens with three papers by Rudiger Dornbusch and Larry Sjaastad. They offer to the reader some excellent illustrations of the monetary approach to the balance-of-payments problem. Dornbusch analyzes in the first paper the impact and the long-run effects of open-market operations, devaluation, and taxation for a small open economy. He uses for this purpose a portfolio-balance model with nontradeable real capital and tradeable financial assets consisting of money and debt. Dornbusch's second paper concentrates on a partial-equilibrium model of financial asset markets with tradeable and non-tradeable securities. He demonstrates that the choice of assets in open-market operations determines the nature of the consequences resulting from these operations. Sjaastad examines, on the other hand, the dependence of short-run fluctuations in the balance of payments on changes in the rate of domestic credit expansion under fixed and floating exchange rates. He concludes that the balance of payments will be more volatile in the short run under a system of floating rates.

The next group of three papers by Pentti Kouri, Michael Hamburger, and Manfred Neumann examines aspects of the German monetary processes during the period of fixed exchange rates. Kouri investigates the extent to which monetary policy is offset by short-term capital flows, concluding that monetary policy was substantially but not completely offset. Hamburger considers the properties of the demand function for the narrowly defined money stock in open economies. His results suggest that domestic and foreign securities are relatively close substitutes in the German context. Neumann weighs the role of the anticipated rate of inflation as one among other determinants of the nominal rate of interest. Estimates of a reduced form indicate that in the shorter run the Fisher effect is closer to one-half than to unity.

Jacob Frenkel and Richard Levich examine the effects of transaction costs on the efficacy of covered interest arbitrage between various currency areas. Their study separates several episodes: the periods of the "tranquil" and the "turbulent" peg and the period of floating exchange rates. They find uniformly — for all periods and all currencies — that profit opportunities are systematically exploited by economic agents once transaction costs are properly accounted for.

The papers by Robert Barro and Allan H. Meltzer deal with the comparative effects of unanticipated and anticipated changes in the money stock on economic activity and the price level. Barro tests and finds supported the hypothesis that only unanticipated changes in the money stock affect unemployment. Meltzer assesses Milton Friedman's proposition that inflation is always a monetary phenomenon by separating a maintained rate of price-level change from once-and-for-all price-level changes. The maintained average rate of monetary expansion determines the anticipated rate of inflation in this analysis. He finds that current and past monetary growth are the principal determinants of the current rate of price-level change.

Various theoretical and empirical issues of monetary policy are taken up in a group of four papers by Benjamin Friedman, Robert Rasche, Helmut Schlesinger, and Kurt Schiltknecht. Friedman analyzes the target-and-instruments structure of the monetary control problem in a stochastic world with full information and a Keynesian structure and concludes that central banks should rely on a targets-instruments planning rather than on an intermediate target-and-indicator conception of policymaking. Rasche concentrates more narrowly on the design of an optimal control rule for the short run when the authorities are confronted with deviations of the intermediate target variable from the desired path. Schlesinger reviews the control experience of the Deutsche Bundesbank since the transition to floating exchange rates in 1973 and explains the Bundesbank's rationale for adopting annual growth targets for "central bank money" rather than for a money stock or the monetary base. Schiltknecht discusses the recent policy experiences of the

Schweizerische Nationalbank and documents the bank's procedure of setting a money-stock target and of controlling it by suitable adjustments of the monetary base.

The final paper by Michael Parkin deals with the indexation problem. A comparative analysis of an indexed and a nonindexed economy establishes that there is no justification for the popular view that indexation introduces a destabilizing mechanism.

We use the opportunity offered by this publication to acknowledge gratefully the continued financial support for the Konstanz Seminars by the Gesellschaft zur Förderung der wissenschaftlichen Forschung über das Spar- und Girowesen.

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