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YGLESIAS

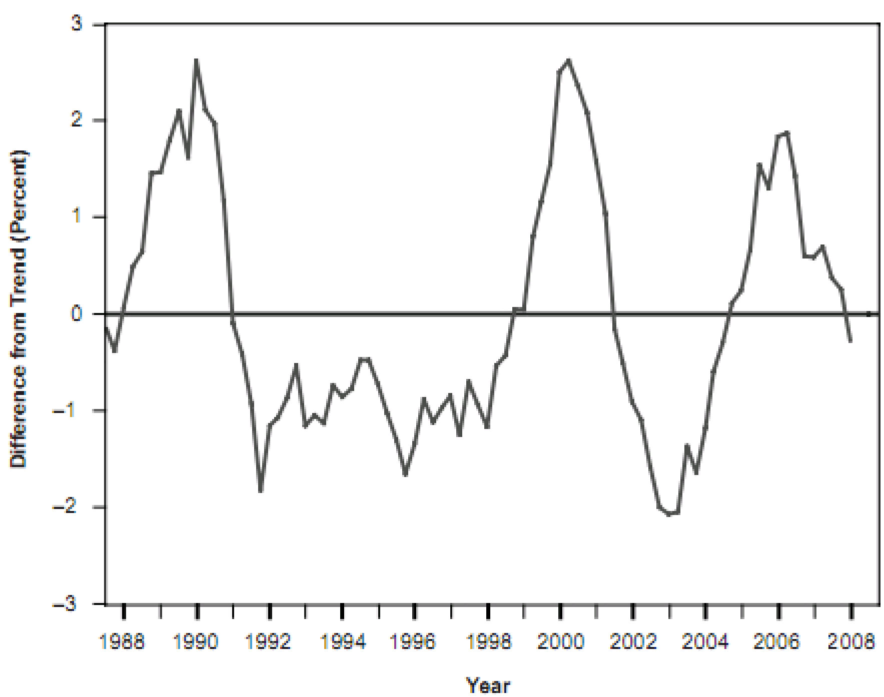
William Niskansen's NGDP-Like Target

Matthew Yglesias on Nov 2, 2011 at 8:28 am

Lee observed on Twitter yesterday that back in 2008, the late William Niskansen was advocating a policy pretty ilar to 5 percent NGDP level targeting as the Cato Institute's official position (PDF):

> The intent of Congress would be better served and monetary policy would be more effective if Congress instructed the Federal Reserve to establish a monetary policy that reflects both their concerns in a single target. The best such target, I suggest, would be the nominal final sales to domestic purchasers—the sum of nominal gross domestic product plus imports minus exports minus the change in private inventories. First, this is a feasible target: nominal final sales to U.S.-based purchasers are almost completely determined by U.S. monetary policy, whereas the rate of economic growth and the inflation rate are separately affected by a variety of domestic and foreign conditions. Second, this target provides the correct incentives: for any rate of increase in final sales, a reduction of the inflation rate increases the rate of economic growth.

Figure 36.1
Nominal Final Sales to Domestic Purchasers



I understand the inventory changes concept, though this isn't a big deal since inventory fluctuations even out in the short-term. The treatment of imports and exports here, though, strikes me as a bit odd. If a horrible infection suddenly destroys the Central American banana crop so net exports fall, we respond with tighter money? Or if Chinese people develop a taste for Rye whiskey, we need looser money? The straight NGDP target seems better to me. You set a trend path for total spending, and commit to trying to stick to the trend.