Some commentators have urged the Federal Reserve to help U.S. firms that export or that compete against imports by easing monetary policy and fostering a dollar depreciation. This is a bad idea, and not just because it ultimately won’t help the traded-goods sector.

An inflow of foreign savings helped finance the 1995–2000 investment boom in the U.S. Despite the slower pace of recent U.S. economic activity, these inflows have continued, enabling a higher rate of investment than would otherwise have been possible. The acquisition of capital improves our nation’s capacity for long-term economic growth and our prospects for a higher standard of living.

As international investors move funds into the U.S., however, they bid up the exchange value of the dollar, thereby putting domestic firms that compete in global markets at a disadvantage. Although a sufficiently expansionary monetary policy could certainly result in a quick depreciation of the dollar, the competitive edge that domestic manufacturers might gain would eventually be eroded by higher inflation. The cost of the temporary improvement in our competitive position would be a permanent hike in the inflation rate. Moreover, a reduced inflow of foreign savings would accompany any transitory reduction in the trade deficit. Some would gain a trading advantage, but others would find financing investments more difficult.