

## GENERAL DISCUSSION

# Macroprudential Policies in a Global Perspective

Chair: Mark Spiegel

**Mr. Spiegel:** Olivier, would you like to take about five minutes to respond to these questions?

**Mr. Jeanne:** Yes. Some papers try to think outside the box and some papers tend to stay more inside the box. This paper perhaps belongs more to the second category. There is a huge literature about international spillovers and the benefits of international coordination of monetary policy and fiscal policy. These policies are the first two pillars of macroeconomic stabilization. There are a lot of debates now about a third pillar, macroprudential policy. But we know very little about the international coordination of macroprudential policies.

What my paper is trying to do is provide a textbook analysis of this question. It is inside-the-box thinking in the sense that it is pretty close to the textbook. That being said, the results are not all obvious—for example, the fact that the lack of coordination between macroprudential policies could be efficient even when it seems mutually destructive.

Moving to more specific points, Jonathan said that in some cases capital controls could actually be the first-best instrument, and I completely agree. First, as I say in the paper, this would be true if foreign investors tend to rush for the exits faster than residents in a crisis. This could be true too in models where debt is in foreign currency and repaying foreigners tends to depreciate the domestic currency more than repaying residents. Thus, in some circumstances capital controls could be the first-best instrument.

Guillermo invited me to think more outside the box, and I agree with a lot of what he said. There are big questions about the extent to which macroprudential capital controls can be circumvented. The impact of these policies has not been identified very well in the empirical literature. This paper does not have much to say about that.

**Mr. Spiegel:** We have time for a few questions. First, from Anil Kashyap.

**Mr. Kashyap:** Olivier was very clear and measured in what he said, but I find myself at these conferences becoming the language police. The word

“macroprudential” to me means something very different in a model where there is something clearly negative like pollution and you’re trying to tax it to reduce it. I think macroprudential is fundamentally about dealing with financial issues, which are only interesting if there’s the possibility of default. And the possibility of default is all about market incompleteness. And when you have market incompleteness, there is no planner, there’s no first-best solution, and there’s probably no second-best. I think we should agree among ourselves that if we’re going to try to talk to policymakers about macroprudential policy, we’ve got to map the landscape about what happens when there are incomplete markets. As soon as you get into market incompleteness, I believe there’s a typology that’s helpful. One set of issues arises if market incompleteness results in some people trying to exploit the possibility of default to make themselves better off—like the too-big-to-fail narrative where the incentives are to privatize the gains, socialize the losses. Then there’s a second set of issues, explored in the Diamond-Dybvig literature on runs, which says that when the financial system collapses, activity collapses. We should map all of this discussion into whether one is worried more about too big to fail, or about runs and collapse.

The macroprudential discussion is totally different depending on which of those two boxes you get into. So as soon as I hear that the planner showed up, I leave the room. Because the planner isn’t ever going to go to Basel. We need to get away from that box, because that intuition isn’t helpful. It is possible that, in the third-best case, you get to some Pareto outcome. But then the whole question is your starting point. Is there overinvestment because you’re too big to fail and you’re basically gambling? Or is there underinvestment because the run collapses the economy? I believe that’s a more helpful way to go ahead.

Sorry, that’s not even a question, so you can ignore it if you want, but if you have thoughts, I’d be curious.

**Mr. Jeanne:** Well, I believe your viewpoint about macroprudential policies is a bit too restrictive. It’s not only about too-big-to-fail or run-and-collapse. One can think of other frictions. I can imagine a world without banks, without bail-outs, without bank runs, some agents in the real sector overborrow. The U.S. mortgage crisis and its aftermath are about excessive leverage in the household sector as much as, perhaps even more than, it is about excessive leverage in the banking sector. To me there is a need for a broader view of macroprudential policy, because financial frictions exist outside the banking sector too.

**Mr. Spiegel:** Okay, I have John Murray and then Carmen Reinhart, and then I think we’re going to have to close this session.

**Mr. Murray:** Just an observation that ties into a question aimed more at Jonathan than Olivier Jeanne. There is a form of social planning, certainly coordination, that is trying to be conducted through Basel and the Financial Stability Board on the macroprudential side. With regard to the international monetary system, of course, the International Monetary Fund is at the center and wants to set itself up perhaps or be even more firmly embedded in that role. But that leads to my question about Jonathan's reference to the need for rules of the game. You observed in passing that they are already spelled out pretty clearly in the IMF articles. It's just that nobody obeys them. Do you have any thoughts on enforcement, since it's very difficult without some sort of enforcement mechanism. I realize this might be a little off topic, but that seemed to be the answer from your perspective to many of the problems we were talking about. Might it fall to the World Trade Organization (WTO) to impose trade penalties to deal with misbehavior regarding currency and capital controls and exchange rate manipulation? Is this the enforcement mechanism for more effective resolution of externalities?

**Mr. Ostry:** Thanks, John, for that. Of course let me emphasize that I'm speaking for myself. What we have in mind in the paper I mentioned in my discussion is something much softer than what you articulated in your question. The idea is that multilateral surveillance, using tools like in the IMF's external sector report and the spillover report, would have some words of caution about external balances or current account balances or capital account balances, including their composition, that are engendering negative spillovers or risks in other countries. You're perfectly correct that in some sense we've had these things on the books for a long time.

We have some discussion in our paper about the extent to which the IMF already has been playing this "neutral umpire" role over the past 20 years. My sense is that we haven't really done it in the way that I laid out. But you're correct, it would take much more if these rules were going to be hard. And I don't think the international community has the appetite for hard rules at this point.

**Mr. Spiegel:** Carmen Reinhart has the last question.

**Ms. Reinhart:** My question is related to some of the points that Jonathan and Guillermo raised about connecting Olivier's analysis to reality. Taxes and domestic borrowing are not a hypothetical. Part of the sterilization of capital inflows has involved big increases in reserve requirements. Now, depending on who pays that tax, it's not the tax exactly that you have in mind, but it is a tax that ultimately is passed on either to the depositor, to the borrower, or to a

combination of the two. So my question is related to Guillermo's point about distinguishing, especially in times of stress, between large borrowers and small borrowers.

In the paper that I did about 15 years ago on precisely the issue of who pays the reserve requirement tax, one of the things we found was that, when the tax is passed on to borrowers, small firms are the ones left in the domestic banking system and large firms go abroad to borrow. This raises the issue of adverse selection. And it raises the question of whether, if you introduce a tax on domestic borrowing, does that immediately imply you're going to have to do something about external borrowing as well? Otherwise, you may wind up taxing the small and medium-sized firms while the big firms go abroad.

**Mr. Jeanne:** So, by going abroad you mean . . . ?

**Ms. Reinhart:** Borrowing.

**Mr. Jeanne:** I'm sorry, I have not explained well what I mean by a tax on domestic borrowing. The criterion is not whether the loan is issued domestically or abroad. By domestic borrowing I mean borrowing by domestic residents, whether they do it at home or abroad. In principle the tax would apply to what you are calling foreign borrowing. When you say foreign, what you have in mind is foreign jurisdiction, right?

**Ms. Reinhart:** The legal term.

**Mr. Jeanne:** Right. So what I'm calling a tax on domestic borrowing is a tax on debts issued by domestic borrowers, whether the debt is issued at home or abroad.

**Mr. Spiegel:** Any last comments from Guillermo?

**Mr. Calvo:** Just a comment complementary with what Carmen said. The experience is that big firms go borrow outside the country when there's an episode of capital inflows. And when there is a sudden stop or some problems in the international capital market, they turn around and fund themselves in the domestic market. Because they are prime borrowers, they tend to drive out the small borrowers, which probably are the ones that are engaged in more labor-intensive activities. So it can have a huge effect on nontradables output, which tend to be labor-intensive, and on unemployment that has no comparison with what you see in the aggregate about credit. Credit may not change much and still there may be a very big impact on the domestic economy.

My other point is related to what Kashyap said about the Diamond-Dybvig model. I think you can go outside the banking sector to have this type of result.

You can generate shadow banks that are completely outside of the banking system and still have the phenomenon that they produce some sort of liquidity that suddenly crashes and has an immediate effect on credit. Using taxes in that context is very tricky. After all, remember that Greenspan kept saying that he was afraid of pricking the real estate price bubble. If you really want to prick a real estate bubble when prices are growing at 20 percent per year, then what interest rate do you have to set in order to dissuade that kind of activity? You're going to hurt the whole economy.

**Mr. Spiegel:** Jonathan, do you have a comment?

**Mr. Ostry:** Just very briefly, on Carmen's question. So there is a literature that documents the harm capital controls do to small and medium-sized enterprises (SMEs). If you're debating between using macroprudential tools and capital controls, you also want to consider the fact that SMEs rely more on banks, and large firms rely more on direct borrowing from abroad. So it's not obvious to me that, if you want to help SMEs, you would opt for macroprudential tools over capital controls. You might choose just the opposite.

**Mr. Spiegel:** Great. Please join me in thanking the panel and Olivier for an excellent session.