GENERAL DISCUSSION

Is There Macroprudential Policy without International Cooperation?

Chair: Reuven Glick

Mr. Glick: Steve, do you want to take a few minutes to respond to the discussants? Then we should have about 10 minutes for questions and answers afterwards.

Mr. Cecchetti: Thank you. I'll try to be brief. I think that our objective was to open a discussion and try to prod people to think about the issue of macroprudential policy. I hope we have been successful. Let me start with Fabio's last point, which also relates to the second part of what Linda said. Paul and I are not talking about time-varying prudential policy in the way people think about things like the countercyclical capital buffer. Speaking for myself and not for Paul Tucker, who is not here, I agree completely with what Fabio said at the end of his comments, which is that this is a dangerous business if you try to do high-frequency policy with prudential tools.

Let me make a couple of other short remarks. Regarding Linda's comment on the desire to have legislative mandates, I believe that in democratic societies it is essential to have legislative mandates. The question is, when is it legitimate to delegate something to an independent institution? There are a number of possible requirements for that, but one that I would say is at the top of the list—which is where I believe that we get into trouble with prudential policy—is that it shouldn't have first-order distributional impacts. Policies with first-order distributional impacts are fiscal. Through tax and expenditure policy society expresses its preferences for certain activities and certain individuals over others. Conventional monetary policy, which has been delegated historically, does not have first-order distributional impacts. But even for that, I think that we would all agree that we get in trouble without a legislative mandate.

Fabio asked about the shortcomings of the current institutional framework, and suggested that we think about possible adjustments. First of all, on the setting of standards themselves, I do not believe this is an issue. The Financial

Stability Board (FSB) is doing a reasonable job. Paul and I have both been "inside the sausage factory." We were involved in setting up and operating the institution, so we have some sense of the problems. And the apparatus of international standard setting could surely work better. I will give you a few examples. The FSB does do implementation monitoring, but all it is doing is monitoring. If we look at what has happened with Basel III, we can see the implications. As we say in a footnote in our paper, the implementation monitoring for the Basel III capital requirement by the European Union has been deemed materially noncompliant. But there is no follow-up or recourse to this finding. Nobody is doing anything to push the European Union to change. A second issue is that the FSB is not set up as an information-sharing institution. Our view is that we need such an institution, especially in the context of stress testing. As we say in the paper, and as Linda picked up on in her comments, stress-test exercises should have a coordinated global component. This could be done in the context of the twice-yearly FSB-IMF Early Warning Exercise that takes place together with the finance ministers and central bank governors of the International Monetary and Financial Committee (IMFC). To us, this seems like a perfect use of a forum that does not appear terribly useful.

The final comment I'll make is that we do not think that the capital controls are a prudential tool of any kind. This is the problem with the term macroprudential and why I don't like using it. Countries have taken the term and decided that almost any intervention that they can make in their financial systems can be called a macroprudential tool and therefore it has somehow been sanctioned. I think that's not right. I'll stop there. Thanks.

Mr. Glick: I have five people on my list. I think that's about all we're going to have time for. So, John Williams, Stan Fischer, Jonathan Ostry, Stijn Claessens, and then Sebastian Edwards, and if there's time, I'll sneak you in, Jeff (Frankel). Okay, so John.

Mr. Williams: Great. I actually thought this paper was exactly what we wanted. I think Steve and Paul did a good job of being provocative and raising high-level issues. I have two questions, and these aren't comment questions; these are true questions. When I read your paper, it kind of reminded me of what my family usually asks me to do at this time of the year, which is to create an Amazon wish list so they can decide what I want for Christmas; and then every Christmas I don't get any of the things on my wish list. And the question is, what do you do then? So you've sent out a wish list which is not that practical and, in a way, we're not close to getting a lot of these things. But there are some things that are happening that aren't on your wish list, and I want to know what you think

about them. One is the provocative, controversial ring-fencing and the intermediate holding company requirements under Dodd-Frank for foreign banks. Do you see that as a good thing or a bad thing? The second question is on stress testing. In the United States, we don't really have macroprudential tools, except for stress testing in a way—and maybe the reality is that stress testing is going to be the primary macroprudential tool in the way that you're thinking about it and not a lot of the other ideas that are out there.

Mr. Fischer: Thanks. I'm not sure that this has anything in particular to do with macroprudential policy, or anything. It's about what do we demand of any international standard. I know that there has been a lot written on this—some of it by Paul—but the notion that you're going to get full agreement on things on which there is not agreement domestically strikes me as close to what John said—it's very nice, it's possibly desirable, but it's not going to happen. So then what? Well, there are lots of bodies that do international cooperation, some of them quite effectively. I have no idea what Interpol does, but it sounds to me that it's a similar organization where you have to have some information. The notion that every country has to know what every other country is doing strikes me as absurd. And there has to be some division of labor and some reliance on a system that will work. I don't see how you can expect me to gain very much by figuring out what's going on in Luxembourg and say that I lose something if I don't quite know the details. So, perhaps you should ask what is the minimum rather than the maximum that you can get. You know, there are divergences on capital requirements at the moment, with the United States doing more than the Europeans. Does that mean the whole exercise has to be abandoned? I don't quite see that.

I do have one more thing: I think that the FSB has made a huge difference, but there is tremendous political opposition in the United States to having "foreigners" setting our regulatory requirements. And I think you're looking for something that won't exist and that it's not a good idea to spend too much time on that. It would be better to look at what is practical.

Mr. Ostry: Thanks. So my comment follows pretty obviously from the comments made by John and Stan, especially Stan's Luxembourg example. When I think of multilateral coordination and cooperation on macroprudential things, what I worry about is large jurisdictions exporting instability to smaller jurisdictions. You don't have to talk about Luxembourg; think of Sweden or Latvia as the archetypal examples. And the solution to that problem is not coordination or cooperation; it is having binding rules of the game, rules of the road to prevent large jurisdictions from exporting instability. So, I'd like to know how

you see that issue—whether what is needed is more like rules of the road monitored by a neutral umpire rather than coordination or cooperation, which as Stan mentioned involves giving up something to get something that's at least as valuable in return. And just a minor point: IMFC, FSB, and IMF presentations always contain a list of to-do's at the end. You may think they are kind of empty, and I might agree with you, but they are the best that the staffs of those institutions can come up with. And, finally, on capital controls, I disagree. They can be a macroprudential tool, as a paper that was discussed at this very conference two years ago showed. Thanks.

Mr. Claessens: Like Linda, I had some confusion about language in the paper. I think it's important to clarify because you talk about steady-state regulations, you talk about resilience, and you talk about macroprudential tools to lean against the wind, and I think that the three concepts are quite different. Clarification of terminology is important. You didn't talk about fiscal issues whatsoever, in terms of burden sharing when things actually happen in the first place. In some sense, what we have seen now in the European context with the banking union brings to the fore that if you really want globalization through cross-border flows and foreign banks, you need to go all the way; otherwise, you're not going to get the results you want. And short of that, I'm skeptical as to whether coordination ever will get off the ground. Are you not fooling yourself and maybe should you then lower the burden in terms of what information you really want to exchange? You mentioned, for example, macroprudential requires a lot of exchange of information. I'm not sure at all about that. I think microprudential probably does. But macropru? On the whole, if you look at overall trends, the problem is that many people don't act when house prices or asset prices get out of whack. Other leverage issues are there. So that's quite different, but seeing the problem is not something about information per se—it's about acting, which goes back to the fiscal. How do you motivate and incentivize people to do what is right for the global, common good?

Mr. Edwards: So, Steve, we're never going to get every country agreeing on this right away. In your table 1, the largest banks are in 11 countries. What is the minimal, critical mass and what would happen to your proposal if some of the largest countries decide to stay out, like in the climate treaties? Is that like multiplying by zero? And it will not happen? And, if that is the case, what is the second-best option at this point—in terms of a process of moving in this direction? Because, as was pointed out earlier, the U.S. Congress hates the idea that we're going to be told by someone, anywhere, what to do. So how do we move in that direction? It's like the Tokyo climate treaty.

Mr. Frankel: We've talked a lot about macroprudential policy, which is a bit of a buzz phrase with economists in recent years. I'd like to just make an observation about efforts for specifically countercyclical macroprudential policy, leaning against the wind—not just in banking, where you can look at whether the reserve requirements are countercyclical, but in housing, loan-to-value (LTV) ratios in the stock markets, the margin requirements. It strikes me that many emerging market countries have made much greater efforts and have experimented with these things much more than the advanced countries have. I'm thinking of Korea, China, Turkey, and others. And I would like to see us make more of an effort to assess that experience. Have they succeeded in calling the cycle right, leaning against the wind—which is sometimes hard to do in real time—and has it had an effect?

Mr. Cecchetti: Let me answer one of John Williams's questions. I agree with your evaluation, that stress testing is the most likely avenue toward establishing systemic resilience.

In response to Stan Fischer, do I believe that we're actually ever going to engage in any of the sort of cooperation and coordination that Paul and I describe in our paper? Probably not. But here, I would say—and I speak for myself—that the United States is a huge part of the problem. And the source of the problem is in large part the fact that the structure of the U.S. system is such that it is not clear who is in charge of what. So, you may have tools, but I don't even know who controls them. Some agencies may have the ability to act—the Federal Housing Finance Agency may have the ability to set loan-to-value limits for home mortgages, the Securities and Exchange Commission may have the ability to set margin requirements for equity markets, and the Federal Reserve Board may have the ability to set capital requirements for certain financial intermediaries. But the biggest problem is that even if I could get representatives from other jurisdictions to the table, I'm not even sure who I am supposed to invite from the United States. And, if I have to live with the United States in its current form, without clarity of representation, then some of what Paul and I envision will not work. And here I can address Sebastian's comment: without the United States, we are in very big trouble.

On the topic of information sharing, I should mention that the banks in Table 1 in the paper—the 30 Basel Committee/FSB global systemically important banks—are currently providing weekly position information to the Bank for International Settlements that is being used to generate an exposure network. This suggests that it is possible to share highly confidential information among authorities. I should say that, while I signed all the memoranda of

understanding, I could never see the data. The data belongs to supervisors and is shared among those supervisors.

Turning to the issue Jonathan raised, we are extremely concerned about spillovers and that countries will react by isolating their financial system. Will they say, look, if you guys aren't going to behave, I'm going to pull away from the system—that maybe the benefits aren't worth the costs? Now, isn't it enough then to have the 100 biggest banks in the world and their jurisdictions—which is probably less than the FSB and Basel Committee, which is 27 right now—involved? Is that enough? Maybe. It might be enough just to get those involved.

Finally, there is the question of fiscal policy and burden sharing. The honest answer is that we do not examine those issues in the context of need for international cooperation on prudential policy. The one related issue that I will comment on is resolution. This is a fiscal issue, and one where there needs to be some agreement on burden sharing. Have we made sufficient progress? I don't know. Thanks for all of your comments. This was really helpful.