GENERAL DISCUSSION
International Coordination

Chair: Fernanda Nechio

Ms. Nechio: Questions?

Mr. Ostry: I enjoyed all of the presentations. I have questions for each of the speakers. Jeff, on the dialogue of the deaf, if people are not playing the same game, is there a role for some third party to explain the rules of the game to all of the players? And Charles, on your point about terms-of-trade manipulation, I didn't quite see what that has to do with the issue of policy cooperation. If people are manipulating the terms of trade, it seems to me that all you can do is try to prohibit that antisocial behavior. It wasn't clear to me that this involved any opportunity for policy cooperation. Lastly, Joshua, on the choice of fixed versus floating exchange rates, what about the middle ground with some currency intervention as a possible optimum for dealing with all the various shocks a country may face?

Mr. Fischer: I just wondered how what Charles talked about relates to Kindleberger's view that the global economic system doesn't work without a hegemon, since, Charles, what you said is that nobody's taking care of the system from the viewpoint of the system as a whole. In fact, I think Kindleberger's view was more about realpolitik, that is, the more powerful will decide what policies to follow. But there is another interpretation of why it's good to have a hegemon and that's to set up missing institutions to help maximize global welfare. And that's how it may well have been many decades ago.

Ms. Shirai: I have two questions for Professor Frankel. My first question is about the current difference in the monetary policy stances of Japan and the European Central Bank (ECB) on the one hand, and the United States on the other hand. This difference in monetary policy stances may actually contribute to the stabilization of the global economy and financial markets. In particular, the Federal Reserve is preparing to normalize its policy rate, and that will put upward pressure on global interest rates, while the Bank of Japan and ECB will continue to do quantitative easing, putting downward pressure on global interest rates. So in some sense the effects of these opposing monetary stances are offsetting and hence may contribute to global stability. Should this be considered as an example of monetary policy cooperation or not? My second question is that, right now, the Bank of Japan and other central banks have currency swap arrangements with the Federal Reserve. This is not a form of direct monetary coordination, but it helped in the sense that, for example, during the 2010–12 European crisis when there was a shortage of U.S. dollars needed by European banks, the U.S. dollars provided by the Federal Reserve through the swap arrangements helped to stabilize the global financial market, because they prevented the European banks from massive selling of U.S. dollar assets and mitigated the stress on the European banking system.

Mr. Williams: First, I'd like to comment on what Joshua said—that policy coordination isn't a panacea. I'm really tired of everyone saying something isn't a panacea. I would like a panacea. So, could we come up with some panaceas? That would be really helpful.

The other comment I have is about Charles's discussion about the difference between the old Keynesian model versus the new Keynesian model. The latter thinks of optimal monetary policy as similar to a public finance problem where policy is used to minimize the effects of distortions. I think this is a great way to characterize monetary policy. In an *NBER Macroeconomics Annual* paper I wrote with several co-authors about 10 years ago, we were doing optimal monetary policy and basically characterized it as a public finance problem using monetary policy tools. But the thing that we learned from our analysis—and this is why I'm intrigued by what you say, though I'm not convinced how important it is—is that there may be many different distortions due to durable goods, sticky wages, etc., which break down the simple relationship between consumer welfare and a standard quadratic loss function of inflation and output gaps. These are Harberger triangles, and as long as you minimize the biggest welfare losses, you're down to very tiny welfare differences between different policies. So as long as you're tackling the big problems, how big of a benefit can there be from cooperation?

And my last comment is that I really liked the way Jeff highlights the point that labeling any policy differences as leading to currency wars is not the right way to think about differences in monetary policy or other policies. Bob Hall has on his website a request that all economists donate a dollar to a charity every time they talk about differences between freshwater versus saltwater economics. He says this is not a useful distinction. I would suggest we do the same, so that every time an economist refers to currency wars, they donate a dollar to charity.

Mr. Frankel: Great comments and questions. I did mean coordination is not a panacea. Floating is not a panacea. I actually have a theorem: I claim you cannot find that anybody, anywhere has used the word panacea unless it's preceded by the word "no" or "not." I'd be happy to see counterexamples. Also the word "silver bullet."

I agree we currently have global policy divergence. The United States has ended quantitative easing and everybody's expecting U.S. interest rates to go up, while interest rates and currency values are headed in the opposite direction in other countries because their economies are weaker. I think the world is operating as it should. Theory is being validated, because the U.S. economy is stronger and that's where interest rates are headed up and the dollar is appreciating. How often have developments matched up with textbook theory so well? Floating works: Each country can choose the policy that suits its domestic conditions. Even though the outcome may not always be perfect, it's working pretty well.

I would say about the swap arrangements that there are times when coordination is necessary, and crisis management is one of them. Without going into detail, I think that that's true both when preparing for crises ahead of time and when managing actual crises.

To Stan (Fischer): Whatever is the best regime or the best institutional approach to crisis management, I think that Charlie Kindleberger was right. You do need a hegemon, if only just to call meetings. If you're going to decide to fix exchange rates, if you're going to decide to float, if you're going to decide to have a trade agreement, someone has to call the meeting and propose what is the best coordination strategy. I think the United States' great contribution after World War II was its role in leading the effort to create new international institutions, such as the General Agreement on Tariffs and Trade, in order to set up a free trade system.

As for the International Monetary Fund (IMF), I'm getting to Jonathan Ostry's comment about the dialogue of the deaf and the possible role for some third party to mediate policy differences across countries. Perhaps he had in mind his own employer. And I think the answer to that is that the IMF does have a useful role. There is a real dialogue of the deaf in the example I gave of the new Greek government, which as of January 2015 was not speaking the same language and couldn't think the same thoughts as the Germans. I think they miscalculated badly. Everybody talked about how the finance minister was an expert at game theory, but he was playing a different game and his country has suffered for it! Tsipras, the prime minister, way overestimated how much power he had and played the game wrong, I would say. That is a case where the IMF could play a useful role and is playing a more useful role as we go forward.

Ms. Nechio: So, we have time for a few more questions.

Mr. Engel: Let me first respond to Jonathan about my using terms-of-trade manipulation as an analogy for optimal policy coordination. I was trying to use it as an example of how the global policy objective may differ from the sum of individual country loss functions. To John (Williams), let me just say that I think everything is a Harberger triangle. And that was Lucas's point, that the costs of business cycle fluctuations are Harberger loss triangles. I also think Joshua is right that ultimately it's the tail risk you're most concerned about, and if you're trying to get big welfare effects, people have introduced utility functions where you really care about tail risk. To Stan, I don't think a global hegemon would go over very well in Congress, but Ben Bernanke was talking about all these central banker meetings held every month in Basel. I felt bad for him, but all I'm saying is that when Ben, Stan, or any other Federal Reserve official goes to those meetings, what ought to be on the table there is a global perspective on issues, such as currency misalignment, that may not be fully reflected from each individual country's standpoint.

Mr. Aizenman: I would like first to reply to Jonathan. I fully agree with you that the middle ground is the way to go, but I'm willing to push it further to address John's comment. My research on the trilemma with Chinn and Ito, and the history of emerging markets over the past 20 years suggests that, if there is any second-best panacea, it's for emerging markets to converge to the center of the trilemma configuration, by giving up some degree of exchange rate flexibility or capital account openness, depending on the relative magnitudes of domestic and foreign shocks.

I cannot think of any large emerging market—i.e., with more than 10 million people—that has performed well in the last 20 years without being somehow in the trilemma middle ground. Allowing controlled exchange rate flexibility may also require being sensitive to the balance sheet exposure associated with foreign-currency-denominated debts.

Mr. Spiegel: I was thinking about Joshua's point—that size has to matter in these analyses—in the context of both Jeff's and Charles's models. In the Nash model, the model is pretty symmetric and both countries have a significant impact on each other. In the New Keynesian model, if you're going to maximize overall welfare, you're probably going to be doing what the large country wants to do. And so, to some extent, when you motivate the question about the merits of policy coordination as Jeff did, all the cool, good policymaker quotes come from the small countries that are buffeted by the policies of large economies. And I'm wondering, what is the paradigm that's going to let us think about the possibility of policy coordination between large economies and small economies that really are subject to large-economy shocks? Or do these models all just teach us that there is no scope for policy coordination?

Mr. Fischer: I have one more comment. The first is that in these coordination games, there may be different policymakers within the same country. At the Bank of Israel, I would occasionally talk to the finance minister and tell him he had to do something about the exchange rate. He said, look, I just spent a year getting a budget through. It was very difficult to change anything, so do me a favor, intervene. And I thought he had a point, because he was going to have a big political fight to change anything, and the central bank didn't have to face a big political fight to get the same thing done, though possibly less well. So, we need to take domestic political situations into account.