Overview

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This was, indeed, an excellent symposium and rightly so as it marches into its second century of being.

I asked an old veteran, Barry Robinson, to help me in preparing my remarks because the title of this session—"What does the future hold?"—is an unbelievable challenge. It's difficult enough to forecast the past, let alone the future. So, I asked Barry to dig information from the Kansas City Fed conference archives on the conference that they held fifty years ago. The president of the Kansas City Fed was H. G. Leedy. William McChesney Martin made some remarks at the conference. The Korean War was going on. President Truman was there. And there was an extraordinary amount of excitement with the Bretton Woods arrangements that had just been introduced five years earlier. Gold was trading at $35 per ounce. The rules of the game were very clear, one degree of freedom in the system. The United States was pegging the price of gold, and all countries were pegging the dollar. The dollar was the exchange standard.

As a matter of fact, the world was very well defined. There was the Soviet Union, two Germanys, and a unified Czechoslovakia. There were the views that budget deficit help. Don't forget this was just a few years after the Keynesian revolution. Inflation was oiling the wheels of growth. Central banks were responsible for motherhood, apple pie, and everything else under the sun. Exchange rate regimes were clear. There were foreign exchange controls. As a matter of fact, Europe was just starting its process to offer liberalization, which will conclude four years down the road. The capital account was closed. It was known what determined patterns of trade. Ricardians knew that technology differed across countries, and that lead to a comparative advantage. It was known that factors of production differed across countries and, therefore, factor intensity abundance determined the partners of trade because factors of production did not cross borders. So, everything was very simple.

Then Barry found a manuscript from the archives. It was the overview session of the conference titled, "What will the future look like?" Before I tell you what it said, let me remind you that as archeologists dig down, the past is always changing. And for economists, the future is always changing. The manuscript said that as we look into the future from 1950, we will see a euro, we will see an ECB, we will see a single currency, we will see central bank independence, we will see a single super power and in a parenthetical question — what is the raison d'etre of a single super power if it has no enemy? We will see the growth of new theories of international trade. We will actually see difficulties in teaching children about clockwise and counterclockwise movements because we have digital watches. And, as a matter of fact, we will see a few years down the road that the concept of a long distance operator does not exist because of the Internet that Stan was just talking about.

Well, you don't have to be Rip Van Winkle to recognize the extent of the change. Nor do you need to dream up a meeting that took place in 1950, as I just did, to motivate the discussion of today.

Chairman Greenspan set the stage very well with his opening remarks. The past reflected a framework in which there was widespread belief of market failure. However, we are now in a different era. Information brings us toward integration, lowering transaction costs. This is true even given the fact that Obstfeld and Rogoff have identified various puzzles that seem to limit integration from being complete.

Alternative approaches disappeared because central planning disappeared. We know that the difference in the characteristics of labor markets across countries reflects the degree of flexibility of these markets. If you want to hire more people and have lower unemployment, you must allow the firing of more people so there is flexibility. This was all said in the opening remarks.

And, yet, Paul Krugman asked, where did the problems come from? And I agree, of course, with Marty Feldstein. Those are three complimentary explanations that he provided rather than alternatives. We are talking about mismatches. Mismatches of maturities, mismatches of currencies between domestic and foreign, mismatches of expectations, some are realized some are not, some are based upon expectations of government response with the seize of moral hazard, etc. Therefore, we think we know where the problems came from.

This brings me to integration of globalization. Integration of globalization also underwent tremendous change. When Gorbachev initially spoke about opening up his system, he said in his speech: "In the new system, what is not prohibited is authorized." This was the concept of a new system to the old regime, which still had one foot in the old system.

Last week, I attended a conference in Montana where a colleague from China reminded us about an old Chinese proverb that says, "The honey is sweet but the bee stings." And, indeed, this is the issue of globalization. We have so many benefits. And the modern version of this Chinese proverb is Tom Freedman's metaphor about a golden straightjacket in which we are all in the same pond, but not all of us fit the same rules of the game. There are some adjustments that need to be made. But at the end of the day, we all have a golden straightjacket.

What makes globalization and integration unique? One, I think it is the end of geography in the sense that the distances shrink and it is the end of empires for the reasons that Mike Mussa mentioned. I would also claim that it is the end of time because in a well functioning capital market, the past is transformed into the present and future expectations are transformed into present pricing and all time metrics are collapsing into a single point. This is essential because it means that a small policy change is affecting the markets, not only through the demand effects but also through expectations about the future course of policies and, thereby, it's transmission to the behavior of current market participants. And, therefore, we should not be surprised that the responses are amplified. Volatility is the name of the game. It is not a distortion. It is a reflection of the fact that time has collapsed into a single point. Things that used to develop over time happen today with some discounting. We have diversity of views that are collapsing into a consensus view, not withstanding the fact that there are demonstrations here and there. But, as Alan Greenspan said, "Ideology gives way to pragmatism" because of the Darwinian process. There is no other alternative. Basically, information technology makes it easier to share knowledge.

Obviously, under these circumstances one needs to be optimistic and I am. How should emerging markets think about this phenomenon in which time is nonlinear? It means they have a chance to jump stages without going through the entire process because technology and information are transmitted to them relatively quickly. As a matter of fact, it means that in the new world there is a chance for the small because the quick beats the slow rather than the large beats the small.

We have much broader markets, and we also have the possibility for much more sensible policies. That's a serious remark. Policymakers and those who deal with policymakers hear over and over the argument, "We agree with you, but not now." We all want to be in heaven, but not yet. The problem, especially with structural policies, is that the cost is incurred today, but the benefits are not gained until tomorrow. And the politicians want to be re-elected. The politicians already missed the first year of their term and it's only two years before the next election. It's too late to start.

But in a world in which time is nonlinear, the benefits accrue much faster and so do the motivations to undertake the right policies. Emerging market destinies depend so much on the performance of the industrial countries.

During my first year at the IMF, I remember that the chairman of the Development Committee told a story about elephants to try and demonstrate the plight of emerging markets. The story was when elephants fight, the grass suffers. When elephants make love, the grass suffers. Too bad for the grass. So, whatever the giant industrialized countries do, the small developing countries are always suffering. This was the sense of pessimism in emerging economies.

A world in which time is nonlinear, in which the future is now, improves the chances that better policies are pursued.

Even though everyone is in the same pond in the era of globalization, a country's own destiny is shaped at home. We have seen this in the Asian crisis where initially investors punished all emerging economies. But it did not take long for the winners and the losers of the beauty contest to be identified. At the end of the day, conventional medicine won out again. There was also a quick turnaround, and this was attributable to the effects of a flexible system where countries did not have to go through the entire journey.

In this regard, I think the emerging economies are joining that positive outlook that Stan was talking about. They have the motivation. Let me tell you a story that describes the lack of motivation. A man who was condemned to die went to the electric chair, but he was too heavy to fit in the chair. So, he was sent home to go on a diet and to come back in one month. When he returned after a month, he was much heavier. When asked, "Didn't we tell you to lose some weight?" He replied, "Well, I did not have motivation." However, in this case, industrialized countries and developing countries have significant commonality of interest. They both have the same motivation.

This brings me to the issue of exchange rates and intervention. Up to now, I have been trying to make the point that we have already left the world of short-run versus long-run transition. There is no in between. I would say the same logic holds for the long-run exchange rate regime. The argument is as follows: For a long time, we were trying to have the best of both worlds—to have flexible rates in order to have some flexibility and fixed rates in order to have some stability.

Little did we know that occasionally we can get the worst of both worlds—the volatility and instability of the flexible rates and the non-sustainability of the fixed rate. Therefore, the dilemma is as you are trying to have the best of both worlds, how likely is it that you will fall into the trap of the worst of both worlds? I will never be convinced by those who argue that it has worked for ten years, twenty years, thirty years, or however long. Because it is a matter of logic, the probability is too high that at some stage you will peg the wrong rate for too long. Then, you will need to yield losing creditability forever because markets remember.

Because markets remember for a long time, it is very likely that in the long run we will not have in-between regimes, but rather we will have either a very fixed or a very flexed regime. And here comes, of course, the digression into very fixed. Does it mean a single currency? Does it mean a currency board or whatever? Or does it mean a complete flex? Whichever, but you need to choose. But complete flex is not panacea. It requires market instruments. It requires a foreign exchange market that is sufficiently deep. It requires regulators and supervisors that provide a level playing field.

And this brings us back to the subject we were talking about. We had some digression, which we already discussed, about foreign exchange intervention. Here, again, I will repeat the same logic. What you cannot do for the long run, don't try for the short run. We still haven't answered Charles Goodhart's question: Why do we need international reserves? Well, we got one answer from New Zealand. "We don't need international reserves. Not only do we not need international reserves because we do not intend to intervene, but we want you, the markets, to know that we will not be able to intervene even if we wanted to." This is a key point because the communication is with the market. Even if the communication is with the market, it brings us to the new framework that Andrew Crockett spoke about on the breed of regulators that are changing from lawyers to economists who understand markets, incentives, and instruments. I am not trying to say anything bad about lawyers, although commonsense must prevail. I don't know how many lawyers are here. But it's nothing personal, especially given the fact I'm just quoting from another.

In the closing ceremony of the Bretton Woods Conference that was held five years before the illusionary 1950 Kansas City Fed meeting that I was talking about, John Meynard Keynes, who was really very sick and tired of the lawyers telling him how to write this and that, said, “If it were up to the lawyers, they would have declared commonsense to be illegal.” But the fact is that commonsense must prevail. Andrew Crockett and Howard Davies described to us how difficult it is with the challenges that the new realities present. But at the end of the day, there is no other choice but to operate with the grain of the market. But if you have to operate with the grain of the market, and you must be transparent—remember that there is a good reason to be transparent because what you get is what you see, and what you don’t see gets you. Market discipline is the real issue. With market discipline, we have to remember what Randall Kroszner reminded us—that there is a fundamental asymmetry between the pair of structures of regulators and of the market participants, and this in and of itself is something for us to reflect.

Without saying anything bad about regulators—because some of my best friends are regulators and I was a supervisor until recently—I must say, at least in a light tone, that there is a lot to be said about the discipline of the market in contrast to just relying on regulators because your can never invite markets over for dinner.

Let me conclude with some words of wisdom that came out in the discussion, including the luncheon remarks made yesterday by Mike Moore. I think this is something we should all take home with us—that you should fix the roof on a sunny day rather than on a rainy day. It is recognizable by all of us that we have a tendency to close the stable doors after the horse has left. So let’s not wait for the rain. He also reminded us that it is always right to do the right thing. The issue is really political will.

This brings me to a question: If everything is well, if the future is already with us, if we are alive in the long run, why is Alan Greenspan not completely optimistic? The reason is, as he says, he’s really a pessimist. And what is a pessimist? It is an optimist with experience. Alan Greenspan has experience. And if I have to summarize his views, I would say he’s optimistic but not sanguine.

Let me conclude with a quote from Mark Twain about Wagner's music. "Globalization is not so bad. It is better than the way it sounds."