

General Discussion: What Does the Future Hold?

Chair: Anne Krueger

Ms. Krueger: Thank you very much. We now open again for questions. Wayne?

Mr. Angell: It seems to me that before we get around to Marty Feldstein's forecast on the dollar, it might do well for us to ask a question. And the question that I would ask is, why isn't the dollar higher today than it is? After all, we've had a most significant period of technological innovations that has increased the rate of return on capital in the United States. And yet the dollar today is only 70 percent, according to my memory, of the level against the mark that it was when we were here in 1985. It is only 60 percent of the level against the Swiss franc than it was in 1985. And as I remember, it is only 40 percent of the level against the Japanese yen.

Now, I believe the answer is that when we were here in 1985, the U.S. equity market had added to our wealth only about 70 percent in fifteen years. Over the last 15 years, equity markets have added five times—our wealth is five times higher than it was when we were here in August of 1985. So, I would hold that the imports that have caused dollar outflow have held the dollar down to a very reasonable level, and maybe I have a non-consensus view that in the future the dollar might be stronger than many expect.

Ms. Krueger: Okay. There's a question in the center. Mr. Barnes?

Mr. Barnes: We can always rely on Marty Feldstein to be controversial, and he suggested that countries could perhaps have an incentive to boost reserves if they invested part of those reserves in equities boost the returns. How would he respond to the argument that this would increase government involvement in the equity market in a dangerous way? Obviously, it raises issues of conflicts of interest and moral hazard, and it potentially complicates the conduct of an independent monetary policy. And you can even argue that it could make private capital flows more volatile as investors try to piggyback or second guess the actions of the authorities.

Ms. Krueger: Mr. Hildebrand?

Mr. Hildebrand: I have been troubled by something that was said yesterday. I think it was Doug Irwin who suggested that educating the masses or the unskilled labor force is futile. This ignores a paradox of global integration: The forces of global integration are, by definition, global, but the impediments to globalization are often national, specifically in the form of national parliaments.

Yesterday, Chairman Greenspan was very critical in his comments on Europe, and I think rightly so. But in order to change many of the things that he pointed out and that are a hindrance to unlocking the potential of globalization, national legislation needs to be passed. This is where the education aspect comes back into play. I would encourage all of us here and the central banks in particular to play that role very actively. We have recently seen what is possible with regard to tax reform and pension reform legislation. At the same time, there has been no progress whatsoever on the labor market side. This lack of progress is what prevents the unlocking of much of the potential Chairman Greenspan referred to yesterday. In order to get national parliaments to adopt the necessary pieces of legislation, intense education efforts are required. I would encourage the ECB, particularly the national central banks, to engage in that process of education and thereby help push the national parliaments in the right direction.

One final point, if you look at the Bundestag in Germany, some-

thing like 60 or 70 percent of the members are either teachers or public sector employees. These are not people who have a deeply imbedded market psychology. The national parliamentary impediments are therefore serious. We have not talked about them here during the last two days. Surely, this is an important dimension to any discussion on globalization. Unless we focus increasingly on the role of national legislation, much of the promise and the potential globalization are going to remain unlocked.

Ms. Krueger: Nick Stern has a question from across the room.

Mr. Stern: I wanted to continue the long tradition of chief economist at the World Bank, giving support and comfort to the IMF. I wanted to underscore and raise one or two issues concerning what Stan said. We have two very strong tasks in bringing globalization forward. It will move forward, but we've got to convince first the poorer countries of the world that it really is in their benefit, and that it is not an easy task, and it is one that is incumbent on us all to take on. And, secondly, we have to help them take advantage of the benefits of globalization. And I think it's a duty of all the people in this room who understand the arguments to put strong pressure on our governments, the U.S., the Europeans or whoever, to open their markets. I think the opportunity that was missed in Seattle was disgraceful. It was largely the responsibility of the U.S. and Europe, in my view, and that is something that people in this room who understand these issues should push very strongly.

And I agree with Marty that the Foreign Direct Investment is a crucial part of the process, and we should work to improve the investment climates in the developing countries of the world. That's good for domestic investment and for foreign investment. And there's a lot that we can do about that. Of course, it's much deeper than just the right macro and exchange rate policy, although those are important. We can work on education, and infrastructure. And, as Stan said, we can help with coping with risk, reducing risks—whether it would be through the international financial architecture, through irrigation, or different types of infrastructure, and so on. So, those are responsibilities that we all have, and those of us in this room have a responsi-

bility to push our governments or authorities wherever on those issues.

But, finally, let me just say something about conditionality and the IMF. It applies to the World Bank too. We must work to simplify conditionality—very long statements about all the things that you're supposed to do and I don't think are that productive. And we have to have a clear definition of the roles. But you cannot expect the IMF or cannot ask them to ignore the structural reasons for the kinds of fiscal and financial problems that generate the crises that we've been discussing. Thank you.

Ms. Krueger: David Gruen?

Mr. Gruen: I want to return to something that was talked about by Obstfeld and Rogoff and then brought up again by Marty Feldstein—the argument that with a current account deficit of 4½ percent of GDP, the U.S. was entering uncharted waters. One of things that happens to uncharted waters is that people sail into them and they become charted! In Australia, in the 1980s, we ran a current account deficit of 4½ percent of GDP on average in the 1980s. And that was very much uncharted waters for us and most of us thought that that was something that was unlikely to continue. But in the 1990s, we again ran a current account deficit on average of 4½ percent of GDP. So, all I'm saying is don't be so sure. You may be right that the current account deficit in the U.S. will decline quickly, but it is also possible that it will not.

Mind you, of course, even if the current account deficit stays where it is, that implies that the cost of servicing the rising liabilities goes up so that your trade balance must improve over that time, which is, indeed, what has happened in a trend sense in Australia and that will be accompanied by a real depreciation over time. So, the real exchange rate in Australia in the 1990s was about 10 percent below what it was in the 1980s. So, it seems to me that even if the current account deficit doesn't decline in the United States, you will still see real exchange rate depreciation. But it may not occur rapidly. It may occur gradually.

Mr. Pardee: Throughout this symposium, no one has talked about a country that has actually fallen back from its global role—Japan. If Japan had been growing in a more natural way during the 1990s, and especially in 1997 and 1998, how long would the crises in Asia have lasted? Probably six months rather than two or three years because both the Japanese government would have been able to play a more active role and certainly the Japanese banks would have been able to play a more active role in providing credit. No one has discussed that. I would like to hear some observations along that line.

Going forward, how can Japan resume its more natural role, given that it is one of the major economies in the world? I would hope that the Japanese government would stop bullying the Bank of Japan. It has been provided independence and for raising short-term interest rates by 25 basis points. The Bank of Japan is now legally independent, and yet when it raised short-term interest rates by 25 basis points recently, top government officials heaped opprobrium on the governor himself, as well as the rest of the Bank.

Ms. Krueger: There's a question back on the aisle from Mr. Kaufman.

Mr. Kaufman: My comment and question is directed to Martin Feldstein. In talking about the financial crises over the last decade, you singled out the problems in Southeast Asia, Korea, Malaysia, and so on and perhaps rightfully so. But you didn't talk about the counterpart, perhaps, to this problem, except you mentioned the IMF. On the other hand, in the West and in the industrial world, Japan pursued a very aggressive monetary policy, the United States an accommodating monetary policy, so did Europe. We in the industrial world, particularly in the United States, created more viable credit instruments—highly liquid and able to move money across borders with great speed. No one forced any of the financial private institutions or investors to put money into Korea or into any part of Asia. We just did it. Therefore, the question I have to you is, do the central banks in the major industrial countries have a broader responsibility in the globalized world? And what should the role of the major private financial institutions be in response, perhaps, to those shortcom-

ings that you spoke about in these various countries?

Mr. Lipsky: During the past two days we've been talking mainly about global and economic integration. Effectively, most of the discussion has been about the lessons learned from the crisis of 1997 and 1998. Looking back historically, if we had been meeting in 1985 to discuss global economic integration, the critical issue would have been policy coordination among the principal central banks and the fiscal authorities of the largest countries.

Implicitly it seems as if we have concluded that although problems remain, the crisis of 1997 and 1998 has been overcome more rapidly than most had expected. On the contrary, the discussions here indicate that it is widely agreed that the most likely potential source of financial and economic instability is the current account deficit of the United States. If this is so, then why haven't we discussed policy coordination among the major industrial countries? Is it because it has been concluded previously that it's impractical, or that it's irrelevant, or even potentially undesirable?

Ms. Krueger: Don Johnston?

Mr. Johnston: I'd just like to say a few words about some of Stan Fischer's comments on opposition. We are veterans of the MAI, Seattle, Washington, Edinburgh, genetically modified food, bologna, and small- to medium-size enterprises. And that's one set of critics. But there are some messages about globalization on the way forward that are very compelling. And perhaps the first is that it is a process and not a policy. And you can move the argument to the issue of process. You automatically engage the serious critics and the question of how you harness the manifest benefits of globalization and mitigate the cost. How do you protect the losers, which we all admit there will be in each of our societies? That's the question Alice Rivlin raised yesterday. That takes us to the area of domestic policy, including labor market reform, skills upgrading, university education, etc., all of which we are engaged in. But that's an important point, I think. It is not a policy.

The second aspect of it, which is also very compelling for many critics, is its significance in terms of the trade and development agenda. I think that the World Bank would be the first to acknowledge that with 1.2 billion people out there living in poverty, this is the only answer. And that's why the work of the OECD has focused so much on the benefits to the developing world of trade and also measuring the benefits, which is another area that's been studied by many, particularly the OECD, and the Brookings. But the problem is, I find very little opposition to the fact that there are these benefits, except from the anarchists. However, from those who say, "It's Wall Street not Main Street that's benefiting." They acknowledge the macro numbers but they do not acknowledge that the distribution is perceived as equitable. In other words, we've learned, as Chairman Greenspan pointed out yesterday, how to create wealth through globalization. Its distribution remains a matter of questions in many critics' minds. That's an area that's very important for us to address collectively.

Now, in closing, I will say something about the central bankers. This has been said by my colleague here about education. I think central bankers have an extremely important role to play as communicators. Politicians have little creditability. Major corporations have little creditability. From what I see in the popular press, central bankers, because of their independence, have increasing creditability. I think many are hesitant to speak out on the importance of some structural changes that have to take place within their own domestic economies and also on the issues of the benefits of globalization. As Stan Fischer said, "We should be defending it." I think central bankers, in fact, are perhaps the best defenders that we can find.

Ms. Krueger: Thank you. The last question is from David Hale.

Mr. Hale: This is a question on the policy consequences of the U.S. current account deficit. I targeted Stan Fischer, but I welcome a comment from Mary Feldstein as well. As we know, the U.S. could soon have a current account deficit of 5 percent of GDP, despite of budget surplus projected now to be \$4 trillion or more during the next ten years. Yet, despite this huge current account deficit, both presidential

candidates are now offering spending proposals or tax cut proposals worth \$1.5 to \$2 trillion. Stan, would you advise the next American president to go slow on tax cuts and spending increases to prevent the current account deficit from growing to 6 or 7 percent of GDP? Or should we let domestic concerns have priority and create the risk that we'll have current account deficit approaching perhaps Irish levels or New Zealand levels in the next two or three years?

Mr. Fischer: Why don't you ask somebody who will actually advise the president?

Ms. Krueger: Okay. We have just about three minutes each for the panelists to respond—starting with Marty Feldstein.

Mr. Feldstein: Let me begin with this issue of investment of reserves in equities. What I have in mind is emerging market countries putting a significant portion of their reserves in a global index fund. So, the manipulation issue is really not a very significant problem. We're talking about amounts that are small. We're not talking about stock selection on deciding to invest in one company versus another. I think that even for a very large emerging market country, the amount you would be talking about would be a small fraction of 1 percent of the global value of outstanding equities. So, it is something that could be helpful to the countries and wouldn't really pose any of these problems.

Regarding the feasibility of continuing in uncharted waters with the current 4 1/2 percent of GDP U.S. current account deficit, there is a difference between trying to raise a billion dollars a day and raising the amount that you need to cover a 4 1/2 percent current account deficit in a smaller country. So, for the U.S. now, we need attract a billion dollars a day and we're doing it. We could continue to do it. I don't think that the current account deficit will go to zero. I don't think that it will collapse overnight. But I do think that it will move down gradually in the future. Part of that will happen simply because of a relative slowdown in the level of economic activity in the United States relative to the rest of the world. But part of it will happen because of a decline in the value of the dollar.

Henry Kaufman asked about the role of commercial banks and central banks in dealing with the flow of funds to the emerging market countries that got in trouble. I think there is probably more room for country-specific supervision. What do I mean by that? I mean for the supervisors, for the central banks, to talk to the commercial banks and others who are doing that cross-border lending about the risks that are involved. It may be that the IMF can play a better, bigger role in providing information to the central banks. They can't speak out publicly about the risks of Korea or Indonesia without perhaps triggering some run on those countries. But they can talk to the central banks. And the central banks, in turn, can provide more guidance, more warning to the commercial banks and other lenders who got overexposed in those countries. Obviously, the commercial banks need to know more about the risks that they are taking there. In a different way, I think this is what you were saying. The Fed was very helpful in the fall of 1998 when it eased market conditions and helped the resolution of the crisis conditions that we had then or potential crisis that we had then.

I don't think that 6 to 7 percent is the starting assumption about where our current account deficit is likely to go. And, as David Hale correctly said, there's a projection \$4.5 trillion surplus over the next ten years. Roughly half of this would, depending on who is president, be either spent or given back in tax cuts and different relevant weights. But still there would be \$2+ trillion dollars that would be added to national savings through budget surpluses. That seems to me to be a big increase in national savings, which moves S-I in the direction that's likely to make the current account deficit come down. And so I don't see any need to have a larger amount than that going forward.

Ms. Krueger: Stan Fischer.

Mr. Fischer: I'd like to start by commenting on Marty's comments on the role of the IMF, which I thought were significantly off base. Regarding the criticism that the IMF created the Asian crisis by spreading alarm and despondency, in a way I wish it was true. It would have been good if we had seen the Korean crisis coming. But

the fact is that Korea ran out of its reserves without much warning from anybody in the official sector. By the time we signed an agreement with Korea, it had no reserves. That crisis was not caused by the spreading of alarm and despondency by the IMF, because we didn't say much before the crises. Nor after the crises began did we spread alarm and despondency by creating pessimistic projections of what would happen in the next year. In fact, the major criticism of the IMF is that we were too optimistic about what was going to happen and that we should have prepared everybody for how bad the disaster was going to be. So, I think that argument is simply wrong, even though it has been repeated by more than one Harvard economist.

Second, and here I follow Nick Stern, there was a critical need to deal with problems in the financial sector and in the corporate financing structure in all the Asian crisis countries, and that was central to the programs. Those countries that have gotten on and tried to deal with those problems have been successful. And those countries that have been unable to deal with these structural problems, for variety of reasons, are still struggling with the aftereffects of the crisis.

Third, regarding a point made by Paul Krugman yesterday, I believe Thailand is getting an unfair rap in this conference. Thailand has not done as well as Korea and Malaysia have, but it has done reasonably well. It has undertaken a fair amount of reform, particularly in the financial sector, where it has not engaged in massive government bailouts of the banking system and has left restructuring largely to the private sector. That's a controversial choice, but they have done a lot in that regard. I would not have put it in the category of Indonesia, which has very special problems.

Next, I'll address Marty's comments on foreign direct investment. Another piece of good news that comes out of the developments of the last few years is that the one category of international capital flow that kept on rising throughout the crisis, was FDI. And foreign direct investment was higher in 1998 than 1997, etc., and 1999 was a record year. The year 2000 is projected to be possibly a little bit lower. But this is something that has held up very well and that is good news, indeed, and I share Marty's emphasis on that.

Henry Kaufman raised the question of industrialized country, central bank policy, and there should be no mistake that we all owe a massive debt of gratitude to the Fed for what it did in the Fall of 1998, which was perhaps the most worrisome period of the entire financial crisis. This action was followed a bit later by the ECB. The only thing I would disagree on with Henry is the statement that nobody forced anybody to keep money in East Asia.

The agreement between Korea and the banks in January 1998 was not forced but it was not entirely voluntary either. John Lipsky asked why we aren't hearing more about policy coordination. I think it's because people have figured out that they are more likely to get coordination if they don't make a big noise about it. And formal policy coordination got a very bad name after the Germans made a mistake in 1978 by becoming too expansionary in the name of policy coordination, and after Japan's asset bubble, which has also been attributed to policy coordination. But if you see what is being said in the meetings of the G7 or if you listen to what Larry Summers is saying, it's time, as the U.S. returns to more sustainable rate of growth, for Europe to take up the slack, and Japan has to get its economy growing. That is about policy coordination, but the discussion is not taking place in the same terms as it was twenty years ago, and without formal agreements on coordinating policies.

Regarding what David Hale said about tax cuts, and what I would say to the presidential candidates: I think an expansionary fiscal policy is problematic at a time of a very large current account deficit that many fear, is not sustainable. And it is a real question whether Marty is right that fiscal policy will remain restrictive and contractionary even after the tax cuts and spending increases that are being advocated.

Finally, let me discuss two more things. One is the role of Japan in the East Asian crisis. The Japanese banks did withdrawal more funds from the East Asian countries than the banks of any other country, beginning before the crisis and continuing through it. That was not a non-market reaction. They were in trouble at home and they needed to bring the money home. But it was a complicating factor and quite a significant one in the crisis.

Secondly, on the weakness of the Japanese economy, there was a remarkable set of numbers on the East Asian recovery in export performance. About a year after the crisis began, around the third quarter of 1998, the exports of the crises countries, taken together, to the United States had risen over the past year in excess of 15 percent. Their exports to Europe had risen by something like 12 percent; their exports to Japan had declined by 15 percent. The lack of demand coming out of Japan was an important factor in the crisis.

Finally, I agree with Don Johnston that we need to engage in discussions with the critics of globalization, to try to understand their concerns better, to change the minds of those who are making what we think are mistakes, and to find ways to deal with the valid concerns of the others.

Ms. Krueger: Jacob.

Mr. Frenkel: I'll be very brief with my three points. First, on the policy coordination remark of John Lipsky, while I partially agree with Stan, I want to add two points. First, the way policy coordination was understood in the second part of the 1980s is now being looked at as having been rather naïve—a very, very naïve way for democracies to run their macroeconomic policies. The idea of the tango principle—I go one step here and you go one step there—is not the way that fiscal policy and definitely not monetary policy should be done.

Second, the system has changed. We now have new realities, which, if anything, require a different nature of policy coordination. It is no longer a coordination of playing around cyclical policies and reconciling differences in the phase in the cycles of various dancing parties but rather understanding that the action is in the capital markets. And, therefore, capital markets are global. It is the globality of the capital markets that requires the globality and coordinated framework of the rules of the game. So, now we talk about the coordination among regulators, about the form of financial stability, and the work of the BIS that Henry mentioned. It's a different form of coordination, and I think it's much more realistic and less naïve.

Concerning Japan, because I spent many years in the official sector, I have been very shy on this subject. But I would like to respond to Scott Pardee's particular question. If we believe that the main problems of Japan have originated from the financial sector, then the key question about forecast about Japan is, what do we believe is the state of the financial sector? Has it been resolved completely? Partially? In my judgment, the progress does not yet warrant the extraordinary optimistic forecast that we now see in the various consensus forecast. We see significant rising assessments about Japanese performance for the year 2000 and 2001. If this is to be true, then it must rest on the assumption that there has been more progress in the financial sector difficulties than I can see now.

Third, I want to make just a side remark concerning the American surplus in the budget and what to do with it. I think that Stanley used an understatement when he spoke about it as problematic to have fiscal policy. I think it is extraordinarily difficult to use this kind of understatement. It's probably going to be terrible to use expansive monetary policy when you have an economy that is still booming and when you have a current account that is still high and rising. When you have large surpluses in the budget, the right way to deal with this surplus is to reduce public debt.

Ms. Krueger: Before I call on Tom Hoenig to close the ceremonies. I just want, on my on behalf, but I hope also and believe also on behalf of all the participants, to congratulate Tom and all of the people from the Kansas City Fed who have done just a wonderful job in organizing and making this a really spectacular conference for us all. Thank you very much.