

Luncheon Discussion: Policymaking in an Interconnected World

Mr. Bernanke: To talk about the international cooperation in monetary policy, you have to include all exchange rate policies as well. And the problem is, of course, that a lot of exchange rate policy is not made by central banks; it's made by finance ministries and so on. So I think you've opened up a much more complicated coordination problem than the central banks' sitting together and reasoning together. What's your reaction?

Mr. Caruana: My reaction is that absolutely you are right, but the fact that the question is more complex, doesn't mean that the question doesn't exist. The question continues to exist and the need—given the externalities that these decisions may have in other policies—the need for additional cooperation may be necessary, but yes, it is quite a complication.

Mr. Fischer: The notion of cooperating on monetary policy sounds very good, but sometimes there are opposing interests on monetary policy. Let me give you two examples, from the viewpoint of a small open economy. One, there's a collapse in industrial country markets, and money comes flying out of them into your country. The small country's exchange rate appreciates, which contributes to the depreciation of the industrial country's currency, and contributes to its

recovery. One could say that's appropriate, because every country needs to contribute to restoring global equilibrium, or to put it in other words, everyone needs to share in the pain created by the policy and regulatory mistakes that caused this mess. One can say that, but it's not a convincing story to tell at home when you are asked to intervene to prevent the recession that would otherwise result. It is not convincing to say we shouldn't intervene because it would be unfair to those countries who created the mess with which we are trying to contend. That's No. 1.

No. 2 is the use of capital controls, and it's really the same issue. The first one was an intervention issue. Everybody's got very low interest rates. Your country didn't have a financial crisis—and this applies to much of the developing country world, and emerging market world—and so you raise your interest rates because the economy's beginning to grow. But as soon as you go much above 1 percent, then "boom," in comes the money. And there goes your exchange rate again. So you decide to do something about it. Now, is this all going to be taken care of in the rules for international monetary cooperation?

Mr. Caruana: I didn't talk about rules, although I would apply the Stan Fischer Lesson 10—never say never. Obviously there are difficulties, and it will not be easy, I think. But I think that in all these cases, a cooperative approach—in the sense of at least sharing the different perspectives of the different central banks, that would be at least the minimum—would be at least a positive step. And if this is accompanied by a little bit of a deep analysis, that would help to see if some of the diverse views can converge. As for disagreeing and having divergent monetary policies, we are already there; so any improvement from the status quo would be a worthwhile gain. Little by little, we could create a framework where these kinds of discussions can be framing in a better way. Still, again, as I started to say, it is true that such a framework does not yet exist. We have something starting, but nothing that can address these difficult questions that you are asking.

Mr. Geanakoplos: You have spoken about monetary policy coordination, but there is macroprudential coordination. So for example, suppose that everybody decides that they want to limit loan-to-value

ratios on securities borrowing or repo borrowing, and if you have American banks that aren't allowed to lend at very high loan-to-values, and German banks are, that would obviously cause a problem. So, do you mean to include these kinds of things in your international cooperation? If you do, wouldn't it facilitate the cooperation to have the decision-making power centralized more in each country? If you have a proliferation of different agencies controlling different things, the cooperation gets harder and harder, so maybe it's an argument for central banks to take on some more macroprudential responsibilities that they always seem to want to pass off to other powers.

Mr. Caruana: Well, I would agree in this regard, certainly. I think it is natural for central banks to be involved directly, one way or another, in this macroprudential policy. I certainly think that we need this kind of cooperation in macroprudential policy. I did not want to go into the macroprudential issues too much in this speech: I tried to say "macroprudential" no more than twice in this speech, which is a record for me, because at my usual speed I say it six or seven times; but on this occasion, I tried to limit myself. But that is not to suggest that it is unimportant.

Let me add that, to some extent, the coordination of macroprudential policy is imbedded in part of the regulation. I mentioned before that, for example, if one country thinks that the capital ratio for their exposure to this country needs to be raised, it is in Basel III that the rest of the countries, the rest of the jurisdictions where banks have exposure, will also accept these rates of capital for exposures to this country; even if it is cross-country. So, something of this macroprudential coordination is already happening.

But with regard to macroprudential coordination, I think we are still in a learning phase. We are still analyzing what the experience has been, and what is most effective, so there is still a long road. But certainly, I would include it as necessary regulation, as necessary as the pure monetary policy, to do this kind of coordination.

Mr. Blinder: It was a very provocative thought and you're certainly right about the stark contrast between cooperation on monetary policy and on the kinds of things you deal with at Basel. But—and

you knew the “but” was coming—I’m thinking about the political economy of cooperation on monetary policy. The notion of central bank independence—which I think everyone in this room cherishes, but lots of people outside this room don’t—is to try to keep the rest of the government out of monetary policy. So the Congress, or the parliament, or the prime minister, or the president, are supposed to keep their hands off monetary policy, and let the central bank do it. How could we maintain that if the central bankers in the world were meeting in Basel to coordinate monetary policy?

Mr. Caruana: I think unfortunately, at least after the crisis, and I don’t know for how long, policymaking is going to be a little bit more messy than we would like it to be, and the notion that some of the action is going to be very near the realm of fiscal policy, etc., is going to be around for some time. So, I’m not sure that just by meeting in Basel, and meeting among central banks, this is the real issue. My view is that the real issue is we have seen that monetary policy is a little bit more complex—we cannot have the simplicity of assigning one instrument and one objective—as soon as you enter close to macroprudential issues. Macroprudential policy has shared responsibilities with government and this is a very complex territory. The only thing that I think can help is to try to clarify exactly what the different roles are; and also to set clear expectations on how central banks may react to different kinds of developments affecting financial stability. At least this would help clarify expectations. But it is not going to be easy. I think, if anything, the cooperative approach would help; but it would not reduce complexity or the difficulties that monetary policy is going to be confronting in the future.

Mr. Frenkel: My comment can be interpreted as a light remark, but it may perhaps have some deeper meaning to it. And it’s really a corollary of a previous comment. The general impression we have is that central bankers are much more aligned with one another in their thinking internationally than they are with their own national fiscal authorities domestically. And we know, of course, that central bankers have international meetings; and we know the benefits of these kinds of meetings: you share values, you share assessments, you share

a way of thinking and the like. And that's why international cooperation is so much easier.

Can you reflect a little bit about how we can use that kind of experience to help improve the domestic understanding of policymaking, to some extent? (I hate to call it cooperation, but let's call it "understanding" of policymaking.) Given what we see today about fiscal cliffs, and fiscal this or that—too many times we hear about "headwinds" with the "fiscal" attached to them—"fiscal headwinds." Very rarely do we hear about headwinds that are "monetary." So we really need to find a way to unclog these fiscal headwinds.

Mr. Caruana: On that I don't have an answer. I would agree. I mean, absolutely, and to some extent, the fact that some of these fiscal issues are not solved puts an additional burden on monetary policy that is, in my view, not right. But I will not try to analyze how the coordination with the political milieu is going to work better. I don't know.

Mr. Alshabibi: This may be an easy question, a very general one: How do you coordinate monetary policy in developing and developed countries?

Mr. Caruana: I thought I devoted a few sentences to that. I think it is key. Today, both kinds of countries are integrated in most of the committees and they discuss the issues. I think that is a key element: that they have this interaction. In addition, as I mentioned, we need to analyze the global impact of varying actions by the different central banks, and when I said that I was thinking about the impact of western economies, large economies, small economies and emerging markets. So, I think this is already happening. The meetings are already happening. That said, perhaps we need to find ways to improve the framework in which these discussions take place and probably we are not yet totally there.

