



A CELEBRATION HONORING
John B. Taylor's
CONTRIBUTIONS TO ECONOMICS
AND MONETARY POLICY

$$r = p + .5y + .5(p - 2) + 2$$

Edited by _____
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to For -
Thanks - John Taylor

President George W. Bush with John Taylor in the White House, shortly after Taylor assumed duties as under secretary of the Treasury for international affairs, June 7, 2001
The White House, courtesy of John Taylor

Taylor in Government

Introduction

Sebastián Edwards

I want to thank the organizers for including me in this great tribute to John Taylor. We have a great panel. I will follow the other sessions and say a few words before asking our speakers to start the conversation.

We're going to talk about John in government in this session. I always thought that public service was sort of the culmination of someone's career. What we see with John Taylor is that he's been in and out of public service from very early on.

He served as senior economist at the Council of Economic Advisers, as a member of the Council, on several advisory boards, and as under secretary of the Treasury. His has been, I think, an exemplary pattern and path for young economists.

I'm not sure when I met John Taylor. I know that as soon as I met him, many of the adjectives that were used earlier, like kindness, immediately came to my mind. We served together in Arnold Schwarzenegger's Council of Economic Advisers for the State of California. You have to remember that George Shultz chaired that council and Milton Friedman was a member, along with Eddie Lazear and Michael Boskin. It was amazing for me, coming from Los Angeles once every five or six weeks. And then, of course, there was Arnold, who was an incredible figure.

One thing that was quite impressive to me about John at that time is that he was very modest. He already was very famous. Already the Taylor rule was around and was dominant.

Barry Eichengreen brought up the book: I think that if you want to understand John Taylor in government, read, if you haven't read it, or reread, *Global Financial Warriors*. I reread parts of it in the last few days. The first chapter has a whole discussion about John spending time in the Situation Room at the

White House. I imagine that Condoleezza Rice, of course, was there, and she may be talking about that in her presentation.

The part I like the most is when John Taylor goes on a C-130 from Kuwait to Baghdad. The first time, as he tells the story, he's dressed just like he is now—dark blue suit, a necktie, and black street shoes. Everyone else on the plane is, of course, wearing combat boots and camouflage dress. It's an amazing story.

You can see John in government around the world. I originally come from Latin America, as some of you know. The story I like about John, and Ann Krueger was also involved in this, is the role he had in the Argentine crisis of 2001. John said, "Well, there's going to be contagion, and the number one contagion from Argentina is Uruguay. But these guys are more or less well behaved. They don't have to fall because Argentina is falling." John played a very, very important role. And every time I talk to people in Uruguay, they always remember John very fondly because of the work he did there.

I personally have benefited a lot from John's work teaching macroeconomics to MBA students. The Taylor rule is a winner. They understand it; they like it, but one has to teach them a few things. One of them is what John Cochrane said earlier, which is, I think, very important: It's not a mechanical rule. You cannot just feed it into a computer and have a computer run monetary policy. It gives you some elements, and then the policymaker has to decide what to do. Every year I offer a prize to my students if they find a country where there hasn't been massive work on the Taylor rule. They haven't ever found it. So I am increasing the amount of money that I give away. Search "India Taylor rule." There are a million papers, literally. Google tells you how many entries there are.

There is another benefit that I've had from John's work. I go around Latin America advising governments. When central bankers don't want to listen to what I'm saying, I drop his name. I say, "My friend John Taylor." They say, "You know John Taylor?" The attitude absolutely completely changes. It's different to say that you know and are a friend of John Taylor. There are some people who ask, "Does he really exist?" It happened to me in Guatemala, of all places.

Let me just mention a couple of additional things. John played a very important role in convincing emerging markets that capital controls were a bad idea. I think that was a battle that largely he won. We're seeing now Argentina lifting capital controls. We'll see where that goes. It's a big question mark, and I am personally optimistic.

Another issue that has to do with John's work in government, and where he convinced me, is whether the exchange rate should be in the Taylor rule. Originally I thought that it should, but we had a lot of conversations and John convinced me that if you have a proper model of inflation, the exchange rate is already there. You don't have to add the exchange rate as a third term.

Let me finish by picking up on three things that were discussed in the earlier sessions that I think are important. One of them is that the Taylor rule is not a mechanical device. It should provide information on the conversation that central bankers have.

The second one is the Taylor principle: Phi should be greater than one. (The Greek letter *phi* is used to denote how much the interest rate should react to inflation.) It's almost impossible, in my experience, to convince a central banker that phi should be greater than one. Someone said in the last session that it's cumulative, greater than one. That you go step-by-step, step-by-step. But it should still cumulate to a value greater than one.

When you tell them that they have to increase interest rates by more than the increase in expected inflation, they say, No way, we are not going to do it. It's happened to me in every country in Latin America, some in Africa, and in Asia. I think that there is something there that has to do with persuasion and how you present that idea.

The final point is something that Robert Barro brought up earlier, which is emergencies and when you put the Taylor rule, or rules in general, on hold while the emergency takes place. I've done some work on what happened in 1933 with the abandonment of the gold standard and the abrogation of the gold clause. That was a great emergency. But I think that we need more work on that issue.

So let me then thank John for all his work and add my voice to the celebration.

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John Taylor: Practical, Creative, and Trusted

Condoleezza Rice

I had the opportunity to serve with John Taylor in government twice. The second time was post-9/11 when we needed to figure out how to trace terrorist financing. It turned out this required economists. John became a key member of the team that created a resolution in the Security Council just a couple of weeks after 9/11, which allowed us to trace terrorist financing.

John had the good fortune to be the person who changed out the Saddam dinar for a new currency for Iraq. I remember sitting in the Situation Room when John described to the president and all assembled exactly what this would entail. He explained that it would require flying a massive transport plane loaded with millions of dinars into an unstable area and exchanging out the currency essentially by hand. I could see the faces of the president, the secretary of state, and the secretary of defense, white as sheets, all thinking, “What are we doing here?” But John pulled it off.

These are relatively well-known stories about his impact on terrorist financing after 9/11 and replacing the Saddam currency in Iraq. The Saddam and 9/11 stories tell us that when someone enters government expecting one thing, they end up doing something quite different. And so, in 2001, we came in expecting a normal set of policy problems, and then 9/11 happened, followed by the Iraq War.

The first time I encountered John in government was in 1989. I had known John and Michael Boskin because they were Stanford colleagues, and I was the young Soviet specialist on the National Security Council staff under Brent Scowcroft. Here was our problem: Suddenly, several countries wanted to leave the Soviet bloc and become our allies and friends. The Soviet system was collapsing before our eyes. The first pin pulled from the Soviet system was Poland’s decision to move from a communist government to its first democratically elected one.

For those of us who had come of age during the Cold War, this was an extraordinary moment. Poland was, in fact, where the Cold War began. But the president had committed to a no-new-taxes pledge, which meant resources were constrained.

When the president called his cabinet secretaries together in August 1989 to ask what we should do ahead of the visit by the new finance minister of Poland, Leszek Balcerowicz, the suggestions were underwhelming. The one I remember most was from the Commerce Department, which thought we should send a trade mission to Poland. This clearly did not meet the moment. Poland was moving from communism to capitalism. We kept receiving bad ideas from various government officials and secretaries.

I heard from Jeff Sachs at Harvard the idea for a standby loan for Poland. Poland could exchange the zloty, backed by international support, to avoid a currency collapse during the transition. But the Treasury Department hated the idea. It was clear that it wasn't going to get done based on the advice of a junior staffer in the National Security Council. I visited my friends Mike Boskin and John Taylor to see what they thought. They wrote the paper that enabled George H. W. Bush to secure a standby loan for Poland through the International Monetary Fund. The zloty was exchanged, backed by a billion-dollar loan that was never used. That was the work of Mike Boskin and John Taylor at the Council of Economic Advisers.

This story reveals something special about what it takes to serve in government. You arrive as an academic with deep expertise—that's why you're valued—but you also need to be practical. You can't tell the Polish people, who had just thrown off forty-five years of communism, that they're going to simply get a trade mission from the United States. You must also be creative and adaptive, and in the moment, John and Mike certainly were. You also must be a leader. You must be willing to take risks, because for the president's Council of Economic Advisers to step in where the Treasury dare not tread was a career-risking move.

Most importantly, you had to be trusted. In all these examples, whether it was flying the dinars to Iraq, crafting the terrorist-financing resolution, or deciding that we could do more for Poland, John Taylor was trusted: trusted by the president, by his colleagues, by foreign governments, and by our allies. That sums up what it was like to work with John Taylor in government. He was an expert—practical, creative, and adaptive—but more than anything, he was someone you could trust to find the right solution at the right time.

Taylor's Implementation of Policy Ideas

John Lipsky

It is an honor and a great personal pleasure to have been invited to participate in this wonderful event in honor of John Taylor, my former Stanford classmate, housemate, and close friend of fifty-six years, standing. I will begin by noting that in preparing for this event, I had the opportunity to reread John's 2007 book *Global Financial Warriors*, his terrific summary of his service as under secretary of the Treasury for international affairs during the hugely challenging period from 2001 to 2005. In his introduction, John notes that policymaking involves first developing policy ideas and then *implementing* them—and that these are differing challenges requiring different skills and methods.

I immediately thought back to our time as classmates in the graduate economics program here at Stanford. The program was quite small for such a renowned department—I think that there were no more than thirty-five students in each class at the time. So everyone got to know each other pretty well. There was no doubt among us that John was going to make a mark in the profession. John's grasp of theory was impressive, matched only by his interest in, and mastery of, technique. His first thesis topic had to be abandoned when it became clear that he was being beaten to the punch by Ed Prescott's research at Carnegie Mellon, work that formed a basis for Prescott's being awarded a Nobel Prize in Economics. But John altered his theme and still was one of the first of us to finish. That work, in turn, formed the basis for one of John's most cited scholarly articles.

If John had any early issues in his career, it seemed to me that his econometrician colleagues found his theoretical contributions to be so important that he must be viewed as a theorist. Conversely, his colleagues working on macro and monetary theory found his econometric work to be so impressive that he must be viewed as an econometrician. That he also became famous for the effectiveness and popularity of his introductory economics courses

suggests another quality—that is, it takes superior intelligence to be able to make complex and difficult topics clear and understandable. In addition, John mentored many notable doctoral students.

My point is straightforward. Even from his student days, John was fascinated by basic principles but also about how to make them applicable. That this tendency helped to give birth to the world-famous and widely applied Taylor rule for conducting monetary policy should have been no surprise. Allow me one humblebrag side note: Despite John's tremendous contributions, he always remained personally modest. It was my Salomon Brothers colleagues and I who lay claim to having named John's policy rule—originally contained in an obscure scholarly paper—as the *Taylor rule*. As Casey Stengel once said, “You can look it up!”

In *Global Financial Warriors*, John notes that one lesson of effective leadership is “to establish a clear set of principles . . . or goals or objectives, or rules . . . and to stick with them as each decision [is] made.” This was so clear in his own actions that at the ceremony marking the end of his service as under secretary of the Treasury, his staff presented him with a plaque listing ten so-called Taylor rules.

I imagine that it is known in this audience that I was Anne Krueger's successor as the first deputy managing director of the International Monetary Fund (IMF). Since my term ran from September 2006 through August 2011, I didn't actually serve at the same time in Washington as John, unlike Anne. However, some of the most challenging situations I faced reflected issues that John also had faced, and rules that he helped to formulate.

First, a few quick remarks about the role of the International Monetary Fund. Popular myth would have it that the IMF initially was created simply to “operate” a system of fixed exchange rates, and when this system collapsed in 1972, it pivoted to making loans to member countries to resolve economic and financial crises. However, it is instructive to peruse the Fund's constitutional Articles of Agreement. In enumerating the purposes of the Fund, the articles begin by charging the institution first with facilitating “the expansion and balanced growth of international trade,” “to promote exchange stability,” “to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions,” and only lastly, “to give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards” (IMF 2021).

As for the IMF's original dollar-exchange system, in which currencies were pegged to the dollar and the dollar was pegged to gold, this always was a

system of “fixed but flexible rates,” as the system contemplated possible adjustments of currencies’ dollar pegs. Moreover, according to a 2004 article by Carmen Reinhart and Ken Rogoff, this system in practice was much more flexible than is commonly recognized. Similarly, the post-1972 so-called flexible rate system today includes sixty-six currencies that are classified as pegged, plus another eighty-two classified as “managed,” but only sixty-six currencies that are “freely floating”!

In other words, the impact of the move from “fixed” to “flexible” exchange rates in 1972 was less definitive than is commonly thought. Instead, the most radical initial change associated with the creation of the IMF was the promise by members to eliminate payments restrictions on current transactions. At the time the Articles of Agreement were covenanted, virtually every member had such restrictions, and their progressive elimination—exactly as contemplated under articles—was a key driver of the rapid growth of international trade during 1950–2007. Parenthetically, this probably was the strongest period of sustained global growth ever achieved.

However, it was another development—and one that by and large existed outside the Fund’s formal purview—that represented the most pervasive change in the international financial system, forming one of John Taylor’s important challenges during his time in office. That was the opening of international capital markets and the ongoing growth in trade in securities—mainly equities and bonds, as well as hedging instruments—rather than traditional bank lending. Remember, the articles don’t give the Fund any direct jurisdiction over capital account transactions. In any case, such transactions hardly existed in the Fund’s early days, and some of the system’s architects—like John Maynard Keynes—didn’t think that they should be permitted at all.

While international bank lending to sovereign borrowers only became important during the 1970s, the growth of the Eurobond market began at about the same time, and by now, securitized capital flows have far eclipsed cross-border bank lending. Moreover, international payments crisis involving bank loans were rather orderly and slow-moving affairs. As a Fund staff member in the early 1980s, I can recall the resolution process involving the leading bankers of the world being summoned to a meeting at IMF Headquarters and being told by the Fund’s then–Managing Director Jacques de Larosière (with Fed Chair Paul Volcker looking on approvingly) how much they were expected to contribute to the resolution of the payments crisis in country X, under terms effectively dictated by the Fund.

However, when the issue is a potential default on sovereign bonds, the challenge is of a different nature in terms of both speed and complexity.

Clearly, a new debt resolution system was required. Hence, there was the effective competition in the early aughts between two prospective alternative approaches to dealing with a payments crisis involving the rapidly growing stock of sovereign debt denominated in a currency other than the issuer's: That was the IMF's proposed sovereign debt–restructuring mechanism—an approach that would have granted the IMF unprecedented bankruptcy court–like powers over sovereign borrowers—versus the much more market-oriented collective action clause (CAC) approach favored by both financial market participants and the US Treasury. John Taylor and Anne Krueger know every detail of the debate, which was resolved in favor of the CACs.

Eventually, more-open capital markets meant the possible emergence of unprecedented payments imbalances and, eventually, more sizeable calls on Fund resources to help resolve crises. Resolution of payments crises always involves striking a balance between finance (in other words, the granting of new credits by lenders) and adjustment (a euphemism for belt-tightening by the borrower). Some folks, including George Shultz, as well as John, worried about the risk of the IMF becoming too willing to provide finance instead of insisting on lasting adjustment in the resolution of crises.

Hence, an effort was spurred by John and the US Treasury to encourage the IMF to develop what was called an “exceptional access procedure.” Under this procedure, rules were developed that, in effect, would limit the prospect of the IMF providing very large financing arrangements (probably viewed by many as excessive as well as exceptional) to a country in debt distress. The details of the procedure that was adopted can be debated, but the goal was justifiable.

However, when the Global Financial Crisis hit—after John had returned to Stanford and I had just arrived at the Fund—the Greek debt crisis exploded, as it became clear that the country had been running unsustainable fiscal deficits (the huge magnitude of which had been hidden in official statistics). At the same time, Greece had managed to become a member of the euro—the European common currency—while effectively remaining outside the single market, thus preserving and protecting domestic inefficiencies while progressively reducing the economy's competitiveness, even while being able to sell sovereign debt on exceptionally favorable terms.

At first, the European Commission and Greece sought to resolve the crisis without involving the IMF, but the circumstances only became worse. Eventually, the situation neared total collapse, and the Fund finally was called in. The Greeks insisted that they wouldn't accept any solution that involved their being expelled from the euro. The European Commission, for its part, insisted

that they would not accept any solution that required debt restructuring, and they were willing to augment IMF resources in the amount needed to make a deal. In the end, they provided two-thirds of the required funding.

It became clear that an IMF program adequate to halt the crisis while preserving these two “red lines”—that of the Greeks and that of the European Commission—was going to fail to meet all the requirements of the existing exceptional access procedure. However, Greece’s membership in the European Union—and its participation in the euro—differentiated it from previous cases (although it was followed by crises in Ireland and Portugal, but those are stories for another day). Greece by definition didn’t have either independent monetary or exchange rate policies to utilize. At the same time, the European Commission feared that the failure to agree to an IMF stabilization program could lead to a systemic crisis that could threaten European stability. As a result, a modification to the exceptional access procedure was accepted—a so-called systemic exception—and the deal was approved.

Unfortunately, while the Fund viewed efficiency-boosting systemic reforms agreed to by the Greek authorities to be the heart of the program, the Greek authorities simply didn’t implement them, and the program failed. The next step was inevitable. The European Commission accepted the need for a debt restructuring, but by then the risk of a systemic crisis had receded. Sadly, it took long years for the Greek government to be willing to make the needed structural reforms that point toward a much brighter future, but happily that is the case today.

There’s another twist to this story that involves John. The Fund’s Articles of Agreement mandate a review of the voting power of member countries at least every five years, in the interest of ensuring that voting power reflects member countries’ “economic weight.” Suffice it to say that since any realignment of voting shares and associated Executive Board chairs is a zero-sum negotiation, it took a huge effort to reach an agreement on an interim alteration at the Seoul G20 Leaders’ Summit in November 2010 that reduced the voting share mainly of European members while rewarding dynamic emerging and developing economies.

The plan was that the Seoul agreement was to be ratified in time for the IMF Annual Meeting in October 2012 and that another set of adjustments would be negotiated in a follow-up round to be concluded in 2015. In the United States, such an agreement requires congressional approval. For whatever reason, the Obama administration did not include the required language to approve the Seoul deal in its 2011 budget. After Republicans took

the majority in the House in the October 2012 elections, it became necessary to get their support for ratification.

For some time, it appeared that US approval might never be forthcoming—which would have been a tremendous blow to international cooperation. The reasons for this stalemate can be discussed, but suffice it to say that the responsibility was shared widely. However, John—who as we know, strongly supports the idea of a rules-based international system—played a critical role in negotiating a solution that was reached in December 2015: The Fund agreed to restore the previous exceptional access procedure—dropping the systemic exception—and Congress agreed to approve the Seoul agreement on “chairs and shares,” as it is known. John proved to be someone—perhaps the only one—who was trusted on all sides to play it straight and whose judgment was respected by all.

Fast-forward to today. The follow-up voting share adjustment that had been promised for 2015 has yet to occur, and no one is holding their breath anticipating a quick resolution under the current circumstances. Moreover, I presume that everyone here [at the Taylor celebration conference] has a view about the current US international economic and financial policies. That wise leadership is needed goes without saying.

At present, John’s former position of under secretary of the Treasury for International Affairs is vacant, and to date, no one has been nominated to the post. Let us hope that someone with John’s wisdom, judgment, experience, and clarity of vision—not to mention energy and determination—is found to take up the critical work that goes with this position. What we know for sure is that we all were lucky that John was on the job when we were faced with a series of unprecedented challenges. And you can look it up—in John’s book, *Global Financial Warriors!*

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John Taylor's Years in Washington

Anne O. Krueger

John and I were colleagues at Stanford. When I joined the Economics faculty in the early 1990s, he was already a long-standing member of the department. We had been colleagues at Stanford for ten years when, at the outset of the George W. Bush administration early in 2001, John went to Washington (again—he had been a member of the president's Council of Economic Advisers under George H. W. Bush) as under secretary for international affairs in the Treasury Department. In May of that year, John called me from Washington, asking if I would consider the number-two job at the International Monetary Fund (IMF). After appropriate interviews and formalities, I accepted. I joined the Fund in September and interacted with John throughout the rest of his tenure at the Treasury (I stayed on for another year and a half at the IMF). On many issues, the concerns of the US Treasury and the IMF overlapped, and we had frequent contact.

The international affairs covered by the Treasury include every major international economic activity in the United States and abroad in which the American government has an interest. His vast responsibilities included US policies and economic interactions with individual countries and with international organizations, both regional and multilateral. Other divisions in the Treasury cover domestic policy and operations, including US government debt, taxes, anti-money laundering enforcement, and much more. The responsibilities of the International Finance Division, which John headed, are far-reaching. They include such diverse things as coordinating economic activities with the G7 and G20 and other international organizations and groupings, dealing with bilateral concerns with individual countries, determining US policy on the dollar exchange rate and US lending to countries in economic difficulty, and having purview over American representation in the

international financial institutions the IMF and the World Bank, as well as in the smaller regional organizations such as the regional development banks.

It is neither possible nor desirable to cover all of these aspects of John's role. Ignoring many other issues he dealt with, as well as the huge management job entailed in covering those responsibilities, I will focus my remarks on several of his important achievements: US actions to support Iraq's initial reconstruction, antiterrorism financing policy, the Argentine crisis, sovereign debt, and exchange rate policy. There were important challenges for policy-makers in each of these and many other issues in which John played an important role, but these five illustrate the depth and breadth of the issues he helped navigate.

Economic Reconstruction of Iraq

Turning first to the Iraqi situation, planning for reconstruction after a war in Iraq was in John's purview and started long before hostilities ended. It is impossible to describe the complexities of planning and then ensuring the functioning of the financial system after hostilities ended. John and his team confronted many challenges, starting with not having the needed data to analyze the situation. Real GDP in Iraq had declined drastically prior to Saddam Hussein's fall, but there were no reliable data. The banking system was, in John's words, a "shambles." Currency had been printed in large amounts, but even data on the price level or money supply were at best intelligent guesses. The government had accumulated debt, but there were no systematic records. Even the IMF had not been able to undertake a report on the Iraqi economy for twenty years.

John coordinated the work of a team he assembled and led. Challenges were everywhere: Destroyed buildings of government offices had to be reopened; records of banks and other financial institutions were not immediately available. Getting finances working again was just one challenge. After the fall of Saddam, John's team had to find a way to pay Iraqis who would be employed in the Finance Ministry and other agencies in the first stage of reconstruction. First, payments had to be made in dollars, and a legal way had to be found to transfer dollars from the Treasury to the Defense Department. Sending new currency involved air-freighting 237 tons of cash, mostly in small denominations, from Washington (and finding records of past asset holders and pension recipients, among other things). The next stage had to be to introduce a new currency, itself a complicated challenge both in the physical sense of getting bills printed and in deciding what claimants should

be recipients. Of course, those elderly Iraqis who had been dependent on pensions needed continuation of payments from Baghdad. After negotiations with British and other counterparts, a printer in London was tasked with producing the paper currency. Devising a plan for the introduction of the new currency was also complex but finally was effected successfully beginning October 15, 2003.

There were many more complications, of course, and I am only mentioning a few of them to illustrate how very complex and challenging the entire process was. Other institutions, including the IMF and World Bank, were heavily involved in different aspects of reconstruction, of course, but US coordination of the effort was essential.

Antiterrorism

The events of 9/11 took place before the outset of the Iraqi war. The 9/11 attack immediately led to searches for ways of handicapping and, if possible, preventing terrorism. Terrorists are, in many cases, operating illegally from bases in countries that may not support them and cannot even control their activities effectively. That immediately raises questions as to how terrorists finance their operations. An obvious part of the answer is that they must have ways of getting funds across borders. After 9/11, attention immediately turned to ways of choking off terrorists' sources of finance. Within a few weeks, President George H. W. Bush announced that the United States, in coordination with its allies, was "cutting off" terrorists' money. Historically, trade sanctions were applied against entities as a means of punishing them or persuading them to refrain from their behavior. They were rarely very effective for very long: There are too many actors willing to route merchandise through third countries, mislabel merchandise, over- or underinvoice bills, and otherwise evade trade sanctions. The longer sanctions are in place, the more ways are learned with which to avoid them.

But with the advent of the extreme terrorist threat, reluctance to use financial sanctions diminished and finally all but disappeared. Financial sanctions have proven to be an almost "nuclear" deterrent as they have come to be used in more and more circumstances. Measuring the effects of sanctions, and especially financial sanctions, is difficult for obvious reasons. Evasion through mislabeling is done to purposefully hide as much as possible from the authorities. When goods are routed through third countries to evade sanctions, it is difficult to find data to sort imports into those genuinely used for trade and those being used to finance activities. But some data can prove quite useful,

such as comparing the magnitude of Vietnam's increased shipments of a good to the United States with China's decreased shipments.

But when money is involved, locating evasion and preventing it is more difficult. Nonetheless, after 9/11 efforts to use financial sanctions increased dramatically. John's knowledge of the financial system and work in the Treasury was crucial. The coordination between the International Financial Division and the Office of Financial Crimes and Terrorism, both of the Treasury, was key, and learning appears to have been rapid. The strategies and methods they devised at that time have proven valuable ever since.

After Russia invaded Ukraine, third-party country sanctions and reduced or removed access from international clearing systems were deemed to have had significant effect, and far more so than efforts at goods sanctions. Third-country party sanctions are a powerful weapon: A foreign financial institution in another country is sanctioned from operating in the United States (and perhaps also among US allies) because it undertook actions on the part of a terrorist-designated group. In the oil trade, "ghost ships" receive oil from tankers originating in a country against whom sanctions have been applied and have proved exceedingly difficult to trace. But even oil on ghost ships must be financed, and some of the (limited) effectiveness of those sanctions is attributable to the use of financial sanctions.

Use of financial sanctions is a dangerous weapon, but an important one. The weapon, once imposed against a particular target, is difficult to reload. There can also be effects on other aspects of economic relations between the party or country against which the financial sanction is imposed and other issues (think the use of Russian oil to heat Europe in winter). It can be over-used or misused, but it is doubtful that the sanctions against Russia in the Ukrainian war would have been nearly as effective as they have been without the earlier work of John and his team. The Iranian acceptance of the need for easing sanctions against the country is another result, at least in part, of sanctions.

Argentina

The United States inevitably is involved in the international community's efforts to mitigate and overcome crises and extreme economic difficulties. John's purview covered countries in such difficulties. I will touch upon only one here, but it illustrates at least partially the breadth and scope of the many challenges that were associated with just one of the many issues with which he dealt. There were many important countries, including Turkey, Brazil,

and Argentina, in crisis early in John's tenure. In these and many other countries, financial and economic problems led them to seek support from the IMF. The United States is the largest shareholder in the IMF and has veto power. In some cases, the US is eager for political reasons to see IMF support reach a country quickly while the IMF fears that economic policy reforms will not be altered sufficiently to enable the country to return to a sustainable growth path. In some other cases, the opposite is the case.

There were notable successes in turning crises around. After a 2001 program, Turkish reforms led to a near-tripling of per capita incomes at constant prices during the rest of the decade. Brazil, too, had almost a good decade after the crisis abated. Argentina was an unusually difficult case and one in which American interests were deemed to be in support of the existing government. The Argentines had a long history of cycles of excessive spending and fiscal deficits, with high and rising inflation followed by crisis (and an inability to finance debt servicing) and then by an approach to the IMF (and bilateral donors) for credit. When economic difficulties became sufficiently severe, the Argentine authorities would seek a loan from the IMF (with additional credit from bilateral creditors). An IMF program would then be negotiated with policy reforms that would improve the outlook and provide a loan to the country for financial support during the policy transition period. Then a gradual or more sudden acceleration of spending would restart the cycle.

Many other developing countries and emerging markets had had similar problems in earlier years. But until the 1990s, most developing countries and emerging markets had used tariffs, restrictions on imports, import licensing and prohibitions, and other quantitative measures to attempt to continue with their policies. When the economic pain was too great, the result was a "balance of payments crisis."

In the half century after the Second World War, experience showed the inconsistency of these policies with satisfactory rates of economic growth and poverty reduction. Starting in the 1990s, more and more countries were shifting to more-open economies and lower protective barriers. Balance of payments crises were replaced by financial crises, as the drying up of foreign exchange (rather than the lack of imports and foreign credit) was the triggering crisis mechanism. Understanding of this new form of crisis was gradually increasing. Argentina was running into serious trouble by the summer of 2001. There had been significant borrowing from private creditors as well as sovereigns. Inflation was mounting, and it became increasingly evident that Argentina would have great difficulty rolling over its debt, much less borrowing

more funds, even before 2001 ended. For a while, stop-gap measures (such as shifting the currency peg from the dollar to a currency basket) were adopted, but by the autumn of that year their futility was evident.

In September 2001, the IMF negotiated a program with Argentina based on information that was either highly overly optimistic or downright wrong (including scheduled debt repayments and anticipated fiscal expenditures and revenues) and on the assumption that Argentina would have continued access to credit internationally. The Argentine authorities simply refused to recognize the severity of their plight. Their data were so far off that when they circulated their numbers to members of the IMF executive board at the Annual Meetings (held in Ottawa after 9/11), it was simple arithmetic (including the addition of omitted variables) to show them wrong.

For the next several weeks, the Argentine authorities failed to come to terms with their plight until finally, in December, they could no longer service their debt payments. The crisis was so severe that the country had five presidents over the span of a few weeks. Even when the gravity and severity of the economic outlook was grudgingly and partially accepted by the Argentines, the authorities only slowly and reluctantly acceded even to measures that were clearly less than were needed. The saga from there is complicated, but John was heavily involved in the situation and worked closely with the IMF on it. In the end, the United States judged it was essential for the Fund to lend to prevent mounting political instability, and a Fund program was initiated despite strong misgivings on the part of Fund staff. Argentina's terms of trade improved substantially over the next several years, and the country's economy consequently grew. But then stagnation set in, and there were repeated crises with high and rising inflation until President Javier Milei was elected in fall 2023.

Sovereign Debt

Until the 1990s, the flow of capital to developing countries consisted almost entirely of trade credit, foreign direct investment (which was largely in primary commodities), and official credits. An exception developed in the 1970s, as the "East Asian tigers"—Hong Kong, Singapore, South Korea, and Taiwan—changed their economic policies from protectionism to openness. As they embarked on rapid growth, profitable investment opportunities rose sharply, but they were very poor countries so savings rose but more slowly.

As these economies resumed growth, they financed additional investment by borrowing from private foreign lenders. The share of official lending in

sovereign debt began falling rapidly. Until that time, when governments (which had been the primary borrowers) became embroiled in situations where they could not continue their debt-servicing obligations, officials from the major creditors met to provide support. They assessed the situation and restructured existing obligations. That was done in conjunction with policy reform as agreed with the IMF and short-term support under IMF programs. There was never a formal group of creditor countries, but the French Treasury served as a secretariat and the creditor group became known as the Paris Club.

In the debt crises of the early 1980s, Jacques de LaRosière, then managing director of the IMF, was able to assemble representatives of thirteen large banks (which accounted for an estimated 90% of outstanding loans from the private sector) and achieve agreement as to the terms of a haircut and restructuring the private and official sectors (not including the IMF, which claimed preferred creditor status). By the turn of the century, there were many more private creditors. Loan documents differed in terms, tenure, voting thresholds, and much more (by 2025, complexity is greater still, because even on the official side, coherence is more difficult as China has become a major shareholder and has declined an invitation to join the Paris Club).

As early as 1996, official creditors had called for an improved arrangement for resolving sovereign debt issues, but nothing had happened. Many observers agreed that something needed to be done. John led the Treasury and the US government in advocating that a collective action clause (CAC) be inserted in sovereign debt instruments that would bind creditors into restructuring arrangements under some circumstances. The IMF (when I was there) advocated an even stronger reform, including the formation of a sovereign debt–restructuring mechanism, which would adjudicate sovereign debt crises (when a debtor could no longer service debts), work with the IMF in projecting future fiscal balances, determining needed reforms, and be empowered to set the terms of a restructuring or rescheduling consistent with the IMF program and lending volume.

The Argentine plight was in many minds as the CAC proposal and the IMF proposal were debated, although the need for a better means of dealing with sovereign debt crises had earlier been recognized. The CAC proposal carried the day, and the effort was led by John. CACs are now part of the loan agreements between most lenders and sovereign debtors. CACs did not entirely solve the problem, but they clearly reduced the difficulties, and getting agreement on them was certainly one of John's major achievements.

The US Dollar and Exchange Rates

The fixed-exchange rate system agreed upon at Bretton Woods in the 1940s served the world reasonably well for over two decades. But by the end of the 1960s, pressures on the dollar were increasing, and by 1973, the Bretton Woods system of fixed exchange rates was essentially abandoned. However, although many countries declared their exchange rates to be floating, they continued to intervene in the foreign exchange market, selling US dollars when they deemed their currency was under too much pressure. Until John came to the Treasury, US administrations had often supported requests for assistance. John, as far as I know, was the first to decline such assistance and advocate a free float.

I discussed some of the many policies in which John was a key player in their determination and execution. But sometimes important policies are ones that do *not* do something. That was, in my view, what John did with regard to the dollar exchange rate, and it was a major contribution. The result has been, I think, better economic policy in many countries. The authorities have been more relaxed about movements in the exchange rate. Those changes have led to earlier recognition of the need for domestic policy reforms. They have also absorbed more of the needed adjustments in policies with less political pushback.

Conclusion

It is hard to get one's head around the scope and depth of the responsibilities of the person in charge of American international financial interactions with the rest of the world. Had I tried to list all of the policy issues in which John played a major role during his time at the Treasury, I would have filled my time with nothing but a long list, and even then I would have missed some.

But to mention just some omitted items, I discussed the original challenge in Iraq but not the major issues with Iraqi reconstruction, which were also a major hurdle. American economic relations with the G7 and bilaterally with other major countries (such as China, South Korea, and Japan) are important and were within John's purview. John was critical of aspects of US foreign aid policy and devoted considerable time and attention to finding ways to achieve greater accountability and assessment of foreign aid programs. He led several plans and policies designed to smooth the Chinese emergence on the world stage in finance and trade.

It was a time of many challenges in the international economy. Dealing with any one or two of them would have been enough for a four-year term. John tackled many more. He deserves as much credit for his bureaucratic career as he does for his academic one. Congratulations on a job expertly well done, John!

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John Taylor and the Dilemma of the Serious Public Servant

Peter R. Fisher

When I think of the meaning of John Taylor's government service—especially his service as under secretary of the Treasury for international affairs—I am struck by John's particular corner solution to the dilemma of the serious public servant. When I arrived as John's domestic counterpart, I thought I knew what was wrong with Washington. I thought a handful of obstinate ideologues, refusing to listen to others, were throwing sand in the gears of government, preventing progress. Senators putting holds on nominations (like mine) for extraneous reasons seemed proof enough. I quickly learned I was precisely mistaken.

I was correct that there are a few people in Washington who will tell you what they believe and that they are going to fight like hell for what they believe, and then they do. They stick to their principles. Most just get up in the morning and stick a finger in the air to see which way the wind is blowing. They are almost impossible to deal with because they do not know what they think; they follow the ever-changing path of least resistance. Progress depends entirely on those who will explain their principles—what they believe in—and stick to them, making it possible to appeal to principle to find common ground in pursuit of a common good.

The dilemma of the serious, senior public servant is this:

1. How much of your limited time and discretion should you commit unflinchingly to a few important principles, both to resist bad ideas and to do the most you can to make at least your corner of the world a better place, at the risk of being branded as having a tin ear for politics, as an obstinate ideologue, or worse?

And, in the alternative:

2. How often should you bend to the political winds of the day—deferring to others, accepting that our federal government has many competing objectives—and accommodate your principles to other priorities and personalities, to avoid standing out as one of the obstinate few but at the risk of doing less than you might to make the world a better place?

Even if he did not actually adopt a pure corner solution, deep down I think John Taylor does not even recognize this as a dilemma. In defending unflinchingly his principles, John helped make the world a better place. To mention just my favorite examples, I recall with admiration John applying his best efforts to use Argentina as an opportunity to lean against providing liquidity to the insolvent and lending into arrears. I also think of his vigorous support for making grants, not loans, to the poorest nations, nudging us in this more sensible direction. In each case, John was steadfast in support of one of my favorite principles: that it is not a good idea to lend money to people who cannot pay you back. It is not good for them, nor for you.

In promoting the use of collective action clauses, against the conventional wisdom, John promoted the important corollary: Nations should not borrow money they may not be able to repay without a plan—any plan—to avoid the problem of holdouts in restructuring. And now, for the last decade, almost all newly issued emerging-market sovereign debt includes collective action clauses (IMF 2020).

Even if John had never made his many contributions to all the different subjects discussed this afternoon, his service at the Treasury would still have struck a blow for financial thoughtfulness and been an example of unflinching adherence to core principles.

George Bernard Shaw explained: “The reasonable man adapts himself to the world; the unreasonable one persists in trying to adapt the world to himself. Therefore all progress depends on the unreasonable man” (Shaw 1903). But Shaw overstates his case. Being unreasonable—or appearing to be unreasonable—may be a necessary but cannot be a sufficient condition to be an agent of progress. Being an unreasonable reactionary, and creating chaos in pursuit of dubious principles, is no guarantee of social or economic advance, as we may now be observing.

History will judge whether the unreasonable man is unreasonable in pursuit of great reason and a greater good or not. We can now judge John as successful. John effectively helped to bend the course of international financial policy in more sensible directions. He helped make his corner of the world a better place—and at some cost.

John, I am grateful for your example and for what you accomplished. I hope you can forgive those who lack the fortitude to risk the slings and arrows that will come if they adopt your resolute solution to the dilemma of the serious public servant.

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GENERAL DISCUSSION

SHIRLEY CHENG: I'm one of Professor Taylor's students, so this event is really inspiring to see. Something that I'm curious about, which we've briefly touched on, is what kind of qualities are necessary for an academic working in government, as well as the different challenges he or she faces. I'm curious to hear more about the challenging aspect of working in the government and how you've witnessed Professor Taylor or other academics navigate those challenges.

PAMELA HAWLEY: Our family is very involved in SIEPR [the Stanford Institute for Economic Policy Research]. I wanted to know, with all of these fascinating stories about the government and economic policy on the ground, if you have recommendations on the best books, white papers, whatever, we can learn from, to see that kind of practical application.

SEBASTIAN EDWARDS: Well, *Global Financial Warriors* for one! John, I'm going to get a cut from the new royalties.

UNIDENTIFIED SPEAKER: I am a sophomore here at Stanford. What was Professor Taylor's contribution in helping track down terrorist financing? What was explained was that he was basically talking with other countries and getting them to come together to be able to track what's going on. But wouldn't that be more of a game of diplomacy than financial policy? How exactly do two intersect?

CHRIS M. MEISSNER: I think Anne Krueger mentioned she wanted to talk about the debt and the dollar and ran out of time. I wonder if she cared to

give us the short version of those comments, since we have a few extra minutes. Thank you.

EDWARDS: One interesting thing that I tell my students, and I think I'm right, is that dollar policy is a Treasury decision. It's not with the Fed, as currencies are not with the central bank in many countries. So dollar policy is a very interesting question.

CONDOLEEZZA RICE: I'll talk about two of these questions. One is about the qualities that it takes to succeed in government as an academic. Academics tend to know an area in depth. In government, it is rare that a policy dilemma appears exactly in your area of expertise, so it becomes a challenge. At the moment you finish your dissertation, you probably know more about that narrow subject than anyone else in the world. You become accustomed to knowing an area in depth. In government, you need to be someone who can take your expertise, ask important questions of people who have other expertise, learn how to ask the second- and third-order questions, and then decide on a solution. Breaking out of your narrowness as an academic is difficult.

The second challenge is pace. As academics we have all year to get something done. A friend of mine often says, "It is a quarter to May, I guess I'd better get started." In government, problems often need to be solved quickly. You do not have perfect information. You cannot keep searching for information. You need to be comfortable with getting to a decision with some uncertainty.

Third, as mentioned, you need a North Star. I have often been asked, what do you do if something is against your values or against your principles? My answer is: Then you don't do it. But the truth is you are almost always trying to weigh competing values and principles, and that is why it is harder than it looks. It is not that it is against my principles but that I have competing principles.

For example, with the economists we would discuss the Section 311 sanctions that Anne talked about, which is the financial equivalent of a nuclear weapon. On the one hand, you don't want to undermine the confidence in the United States and in the dollar, which would discourage the United States as a good place for investment. On the other hand, what other strategy are you going to use against the Russians when they invade Ukraine? It is usually competing values, not one set of values or another.

Finally, to the interesting question about diplomacy and why the terrorist financing fell to the Treasury Department rather than the State Department. Of course, the State Department had an important role. But understanding how financial flows really worked, particularly through the shadow banking system that had arisen, was fundamentally an economist question. When it comes to diplomacy, you need to work closely between the State Department and Treasury Department to get the job done.

EDWARDS: Thank you, Condi. John Lipsky, you had a very long, successful career in the private sector, investment banking. Maybe you can tell us the difference between the skills required for that and public service or being in government.

JOHN LIPSKY: Good question. I can talk specifically about coming to the International Monetary Fund. I'll begin by referencing what Condi said about having a North Star. When you're trying to accomplish things in the context of a multilateral institution, it's inevitable that at each step you will have to compromise in order to reach agreement. However, you can't let yourself get discouraged. To reach your goals, you have to be able to take a long view—to keep pushing, to keep at it. You can't expect quick wins or anything approaching instant gratification.

In addition, one important thing that I did find when I came back to the IMF from investment banking was a surprising difference in the way senior managers and officials interacted with their colleagues. As a senior manager in investment banking, you focused much of your efforts on who was staffing your organization, on their career development, on how they related to one another, and on the challenges facing the group. Your primary responsibility was to make sure that you had the right people in the right positions, that they were being developed and supported, and that they were working well as a team. Managers were evaluated on this basis, as well as on their business results.

When I came back to the Fund, I found that often senior people worried more about whether their staff were producing the right answers. One result was a tendency toward everybody checking the work of their staff, such that it seemed that reports were checked and rechecked. I thought that senior Fund officials needed to spend more time making sure that they had the right people in the right positions rather than marking their tests. In recent years, it

is my impression that Fund senior management has spent substantial time and effort moving things in this direction.

ANNE O. KRUEGER: I understood also the question about the transition from academia to government, and I would respond at least partially differently from John Lipsky. First, there are some people who go into government or one of the international organizations; they learn something there, often things important that are not necessarily academic; and then they transition to not necessarily the very top universities. Quite a few of them do go into teaching and become very good academics. Some of them have an area in which they know a lot, so they publish quite satisfactorily from the viewpoint of the standards of the university. Some people do it the other way. They go into academia and after a while move over to government service. It also has been the case that many people in the government have wanted to hire academics for particular consulting purposes, which gives some exposure and gives you some insight.

At least for me, that was an important learning route. I was doing a lot of work on developing countries. In fact, when I went to the Fund, had you asked me, the countries I knew most about were Argentina, Turkey, and Brazil. They were three of our five most important problem cases at that time, ones that I had been working in quite recently and had a fair background in, not because I'd worked in government but because I'd worked in consulting with them.

There are other ways, too, but I think the point Peter Fisher and Condi both made is important, and that is there has to be some flexibility in the sense of adapting to the others around you and what the regulations and the constraints really are. That's important. No matter where you come from, when you get into government, the politics are there. And you can't say, "I'm going to ignore it." You can say, "How do I use it?" This is the best you can do, and you can hope.

PETER R. FISHER: I'll just briefly touch on this question of how to operate in government. Something the late economist Bob Glauber taught me before I became under secretary is ringing in my ear. In 2001, it looked like we were headed into a recession. I asked Bob, who was teaching at Harvard at the time, for advice about how to do my job as under secretary for domestic finance.

He said, “Peter, you need to know you won’t have time to read anything and that what you will be doing is more like performance art. People will come into your office with a problem. You have to diagnose it and suggest a course of action on the spot. You don’t get the chance to go read the briefing memos after the fact.” That’s an extreme version, I think, of what Condi’s saying about how you can’t wait around. You don’t get a lot of time, and you’d better take whatever tools you have and then apply them. So that’s a little piece of advice.