Introduction

Since the end of the Great Recession in 2009 the central banks of the advanced countries have taken unprecedented actions to reflate and stimulate their economies. There have been significant differences in the timing and pace of these actions. These independent monetary policy actions have had significant spillover effects on the economies and monetary policy strategies of other advanced countries. In addition, the monetary policy actions and interventions of the advanced countries have had a significant impact on the emerging market economies, leading to the charge of "currency wars."

The perceived negative consequences of spillovers from the actions of national central banks has led to calls for international monetary policy coordination, including one by the general manager of the Bank for International Settlements, Jamie Caruana, another from the former chair of the Federal Reserve, Paul Volcker, and a number in papers at the European Central Bank's policy conference in Sintra, Portugal, in June 2016. The arguments for coordination based on game theory are the same today as they were back in the 1980s, when they led to the Plaza and Louvre accords of 1987 and 1988, respectively. Both accords, which required that participant countries follow policies to improve global welfare at the expense of domestic fundamentals, led to disastrous consequences, especially the Japanese boom and bust of 1991 (Taylor 2016).

An alternative approach to the international spillovers of national monetary policy actions is to view them as deviations from rules-based monetary policy. In this view, a return to rules-based monetary policy and a rolling back of the "global great deviation" by each country's central bank would lead to a beneficial policy outcome without the need for explicit policy coordination.

In this book, we report the results from a recent conference which brought together academics, market participants, and policymakers to focus on these issues. The consensus of much of the conference was on the need for a classic rules-based reform of the international monetary system.

The book contains five chapters that cover international monetary policy interactions from different perspectives: theoretical, empirical, and historical. It is followed by two chapters that contain the discussions of policy panels by practitioners and policymakers. All of the chapters contain an edited transcript of the general discussion by all participants in the conference.

In chapter 1, Sebastian Edwards demonstrates that Federal Reserve monetary policies had significant spillovers on the emerging market countries of Latin America and East Asia despite floating exchange rates. This raises questions about the ability of the central banks of these countries to exercise independent monetary policies. David Papell in his comment considers whether this was due to recent departures from optimal policy rules in the United States, concentrating on the concluding lines of Edwards's paper, which assert that "to the extent that the advanced country central bank (that is, the Fed) pursues a destabilizing policy, this will be imported by the smaller nations, creating a more volatile macroeconomic environment at home."

In chapter 2, David Beckworth and Christopher Crowe demonstrate some of the destabilizing impacts of such policy spillovers, especially when the United States is "banker to the world," with a large portfolio of longer-term assets financed by short-term liabilities. They consider ways in which more rules-based policy could alleviate these international instabilities. In his comment, Christopher Erceg raises some empirical issues and notes that the results imply a positive effect of US policy deviations (shocks to policy rules) on real gross domestic product abroad.

In chapter 3, V. V. Chari and Patrick Kehoe examine rules-based policy in the context of a currency union such as the European Monetary Union. They show that currency unions bring about more rules-based and less discretionary monetary policy, but note that such unions have disadvantages in dealing with incentives to bail out the debt of member countries. In his comment, Harald Uhlig explains in detail the nature of the assumptions and notes that some of the price-stability effects of monetary unions observed in the countries of Europe are also observed in the United States.

In chapter 4, Pierre-Olivier Gourinchas, Ricardo Caballero and Emmanuel Farhi discuss the results of their model, which shows the existence of the zero lower bound on the central bank interest rate combined with a shortage of safe assets in the global economy. This gives rise to the current account imbalances that we have observed in recent years. John Cochrane in his comment questions the relevance of the zero lower bound, and he argues that real factors such as the marginal product of capital provide a better explanation of what is going on in the world today. While praising the paper for laying out a model that could be discussed substantively, he also questions the existence of an aggregate deficiency so many years after the crisis.

In chapter 5, Michael Bordo and Catherine Schenk provide an historical overview of central bank cooperation and coordination, with focus on the importance of rules. They cover a range of different international monetary regimes, from the classical gold standard and interwar gold exchange standard, to Bretton Woods, to the 1980s and 1990s, looking at particular episodes of formal policy coordination. Their overriding finding is that systems that are more rules based and do not require active coordination of policy actions work better than more discretionary systems. Their discussant, Allan Meltzer, delved into some of the reasons underlying their findings based on his studies of the history of the Federal Reserve.

Chapter 6 contains the discussion from a panel of three economists with experience with international economic policy coordination at the US Treasury—Richard Clarida, George Shultz, and John Taylor. They discussed "Rules-Based International Monetary Reform." Clarida explained how his own research led to the conclusion that a nearly optimal rules-based international system could be generated by optimal rules in each country. He also emphasized, however, that certain inherently global developments—such as a change in the equilibrium real interest rate—required an analysis of trends in other countries. George Shultz described how international reforms that first brought about flexible exchange rates were implemented in practice during his own experience as Treasury secretary. John Taylor reviewed his proposal for a rules-based international monetary system in which each country announces and commits to its own policy rule.

Chapter 7 contains the discussion of the final panel on international monetary policy and reform in practice by four current members of the Federal Open Market Committee: James Bullard of St. Louis, Robert Kaplan of Dallas, Dennis Lockhart of Atlanta, and John Williams of San Francisco. Despite some mild disagreement, there seemed to be a lot of consensus that the equilibrium real interest rate (r*) had declined. This did not have much bearing on their current interest rate decisions, but it meant that gradual normalization would be to a lower rate than expected. In addition, Jim Bullard presented an analysis in which deviations from optimal rules-based policy could cause instabilities in other countries, a possibility raised by Sebastian Edwards in chapter 2. Considerable discussion with the other conference participants led to a general consensus, summarized by George Shultz, in favor of a rules-based monetary policy and international monetary system, although there was some disagreement on what the rule would be.

References

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