

The Coordination of Economic Policies

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A distinction was drawn earlier between cooperation and coordination, where cooperation means sharing of information and all the rest. And the argument has been made that once you share information you cannot really avoid coordination as well. Since we are on the eve of Columbus Day, let me just share with you information that I received yesterday from our colleague Buirra; I think that it will raise the welfare of all of us. He says we are all economists, we are talking about cooperation and Columbus Day. What is common to Columbus and economists? The answer is both left their home place without knowing where they would arrive. Once they arrived, they did not know where they were. And both did so at public expense.

The title of this panel session is so dramatic, almost Shakespearean—To Coordinate or Not To Coordinate—that obviously we cannot offer a very simple answer. So in outlining my ten minutes I thought of at least four w's and one h that one has to address, namely: why coordinate? what to coordinate? who should coordinate? when should coordination take place? and finally, the how. Well, we do not have time to go through all of that, so I will just indicate some of the answers.

The intellectual case for coordination is rather well known and obvious, especially in view of the discussion this morning. We know that capital markets have become more and more integrated and that floating rates have turned out to be less than insulating. In other words, there are externalities, and when one country is under tight policy measures, it affects the rest of the world. And if there are externalities,

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we feel that there must be a mechanism to internalize those externalities, in order to bring us to something consistent with a global welfare. So in this context, coordination can be thought of as the mechanism that is used in order to internalize those externalities. But this suggests in general the perspective that we see in some of the public pronouncements that country A should take into account the effect of what it does on country B, and therefore be "a little more realistic." That is really the non-argument. The argument that should be used is the argument of self-interest, the argument that basically a nation is in the same boat with others. October 1987 illustrated it, and as a result we see that it is in one's self-interest to recognize that one is in the same boat with others.

Now the process of coordination or cooperation tries to resolve the paralysis that arises from excessive politeness, where everyone says, "You go first." "No, you go first." The notion of coordination is to try to get out of this particular bind. Of course all of the dangers of coordination that have been already mentioned divert attention from the real fundamentals that are out of line. Coordination may be on the wrong policies. Countries do not share objectives. Countries do not share beliefs about the way the economic system works. But all of these, I think, are arguments against bad policies rather than arguments against a mechanism for internalizing externalities, whether it is cooperation or coordination. No system can be designed that is immune from bad policies, so the real question is whether a cooperative framework will generate marginally somewhat better policies. Now what perspective should one take? On the average I would say "No." I would say in cases of crisis, in extreme cases, that is where coordination counts. I don't know how many times the red telephone has been used, but it is there precisely for that particular extreme case. Now you may say, "Why have these ongoing meetings, if the cooperative framework is useful only to resolve an extraordinary crisis?" The answer is that it is very difficult to have a club where you can decide unilaterally that you're going to go out, take the key with you, and come back when you want. If you are loud enough and you leave the club, even with the hope of coming back, you may not find the club when you return. Coordination is something that has to be routinely part of an ongoing process. One of the difficulties we have is that excessive drama has been associated with all of these meetings, and therefore a lot of expectations, resulting in a lot of frustrations. Many, therefore, would like to have this machinery in place on an ongoing basis, where most of the time it is sharing information and things of that type and occasionally it is extinguishing important fires.

About the next question, what should be coordinated, well, one should probably back up and say what we should avoid. I think we should clearly avoid coordinating the instrument that happens to be the

easiest to coordinate, or we will also end up with the fallacy of the lamppost and the coin. It is indeed the case that monetary policies are the most flexible and have the machinery for communication. Monetary authorities meet on a regular basis. But before long, you also end up saying that political reality dictates that fiscal policies are slow; we cannot do much, there are election cycles, so let us focus on monetary policy. Then you end up wishing to have targets on interest rates, because you worry about that, and growth and investment; you worry about inflation, you worry about exchange rates. Finally everything is loaded overwhelmingly on monetary policy, and that is an important danger one should avoid.

On the other hand, one has also to avoid over-coordination. One should not, of course, have a situation where one ignores the political reality that sovereign states differ. And, therefore, one has to have enough safety valves to allow the steam to go out without necessarily creating a crisis. There must be room for a real exchange rate change, if circumstances necessitate it, and there must be room for some flexibility, so that not every little change means loss of credibility.

Let me say a word here about the INT, International Nominal Targeting. One of the dangers of having those kinds of initials is that international nominal targeting may also be thought of with INT—Independent National Targeting—and I think a danger lies there. How do you end up creating good initials that bring you to the right thing?

When should you coordinate and why? As I said, I believe that you cannot expect or, therefore, call for anyone to undertake a policy that is against his own perceived interest. So why should one coordinate? I would like to think about it as a Weight Watchers' Club. Some of us join a Weight Watchers' Club and you wonder why. After all, if you want to go on a diet, you do it. But the fact of the matter is, we do not go to a Weight Watchers' Club to do what we do not want to do, but because we think that somehow the peer pressure will be helpful. When I think of some of the actions that have taken place during the last year on the budgetary side, maybe in Japan, and even the limited budgetary actions in the United States and some other policy actions, it would be hard envision them taking place at that particular time without the "Weight Watchers' Club" discipline.

Who should coordinate? Well, again, the G-3 already exists, and the G-5, G-10, G-7, G-22, G-24, G-77. We know that such groups should definitely include those whose actions matter, so the major industrial countries should be there. And how do you incorporate those who are affected by these actions? Here the procedures are very important. I want to say something about the line that Jeff Frankel suggested, the nominal income targeting and the indicators, and what the G-7 should set aside. The process itself of coordination has turned out to be extremely important. The choice of indicators never emerged from any

request to the economics profession to supply (in its wisdom) the single indicator that will do the job. So, therefore, I do not believe that this should be regarded as the final revelation. We must understand why the initial set of indicators was chosen, what political equilibrium it has established, and how we can replicate what has been accomplished using whatever more efficient process is available.

Let me just mention one or two last points. First, one of the things we have to keep in mind is that we economists think of policy instruments as the things that we use in carrying out the policy actions; therefore, we have tax policy, fiscal spending, and defense, and all the rest. Now there is a little problem when some of these instruments become objectives rather than instruments in the particular case, because of other considerations. So suddenly defense, for example, and taxes, are not so much instruments but are themselves objectives.

And, finally, the coordination of economic policies is a subset of a broader domain of coordination and cooperation among sovereign states. It is very difficult to take a specific summit and to look at the deals that have been struck there on economic policy without concluding that somebody seems to have given more and somebody else to have got less. The accounting must be done in a broader context, since countries have broader relations with others involving defense and otherwise, and the economic summits are but part of it. You may then ask another valid question: If economic summits are only a subset of the broader range of relations among countries, why should we limit a session to just economic matters? But, I guess that is a question for a different time. Thank you.