Policymaking in an Integrated World: Discussion

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Barry Eichengreen's main message is that the new financial architecture should be organized around four pillars: (1) international standards for financial arrangements and practices; (2) Chilean-style taxes on short-term foreign borrowing as a form of prudential regulation; (3) greater exchange rate flexibility for the majority of emerging market economies; and (4) collective-action clauses in loan contracts. Further, he argues that the International Monetary Fund (IMF) should be made independent and accountable (following de Gregorio, Eichengreen, Ito, and Wyplosz 1999).

Let me start by commenting on this last point. Coming from the European Central Bank, I may be excused for having a strong prejudice in favor of an independent and accountable institution. Nevertheless, I would stress that conditions for setting up an independent and accountable institution are very demanding. First of all, in order to be accountable, the institution must have an explicit mandate. Eichengreen's suggestion here is "to maintain economic and financial conditions and facilitate the pursuit of economic and financial policies that maximize stability, prosperity, and growth." It strikes me as close to impossible to make anybody accountable in any meaningful sense on the basis of such a wide mandate. A second and related point is that if the mandate needs to be very broad, then one can wonder if it is really appropriate to think in terms of a contract between principals (the IMF shareholders) and agent (IMF). The degree of discretion implied would be incompatible with delegation. Third, independence is a demanding notion. It is not

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sufficient to write that an institution is independent. It is crucial that the institution be given the means to be independent and have control over instruments effective in delivering the goals specified in its statute. Given, for example, the financial means available to the Fund and its (limited) regulatory competence, it seems clear that those conditions are not in place.

Regarding his four pillars, I mostly agree with Barry Eichengreen on the need for international standards and for collective action clauses in loan contracts. Therefore I will concentrate my comments on the other two.

Chilean-Style Holding Period Taxes on Capital Inflows

My starting point is that the globalization of international financial markets contributes to a globally efficient allocation of resources. Savings can be allocated to the best available investment opportunities, and the possibilities for consumption-smoothing and the spreading and diversification of risk are expanded. At the same time, the continuous scrutiny of national policies and the competition among different ways of organizing and regulating financial markets should provide incentives for sound and efficient collective action, both public and private. Reading page 2 of the recent book by Eichengreen (1999) on the same issue, I think that we are in agreement here.

I also agree that adequate self-regulation, and the imposition of adequate standards by supervisory authorities, are essential elements for well-functioning financial markets. I further agree that the timing of capital account liberalization is a crucial decision for the concerned national authorities. The complete removal of capital controls requires that adequate legal, regulatory, and supervisory systems be in place. Nevertheless, in my view, capital controls have to be seen, at best, as a temporary, transitional measure. Capital controls are never part of a first-best or possibly even a second-best setting. There are at least two reasons why we should be cautious about capital controls: First, empirical evidence suggests that their effectiveness cannot be taken for granted.[1] Capital controls will always be circumvented to a greater or lesser extent. Second, and more important, capital controls cannot be a substitute for an adequate legal, regulatory, and supervisory framework. There is a danger that capital controls will be seen as a panacea leading to the postponement of necessary structural reforms. Further, capital controls are known in some cases to have led to corruption.

[1] See, for example, the paper by Sebastian Edwards in this volume.

Greater Exchange Rate Flexibility for the Majority of Emerging Market Economies

Given that Figures 7.1. and 7.2. in Eichengreen (1999) show an increasing proportion of developing countries opting for flexible exchange rates, one wonders if this pillar should be regarded as positive or normative. In any case, let me assume that the relevant question here is the following: What is the "right" exchange rate regime for a small, open, developing economy in the context of an open (or increasingly open) capital account? A useful starting point is to recognize the need for consistency between different elements of the macroeconomic regime. Padoa-Schioppa (1987) formulates the point as follows: "Capital mobility and exchange rate fixity together leave no room for independent monetary policies." Many financial crises in the nineties illustrate the proposition that adopting an exchange rate peg without meeting the necessary pre-conditions—that is, with an inconsistent economic regime—can lead to very spectacular crises.

Nevertheless, I am skeptical about the proposition according to which, in a world of unrestricted capital movements, the only sustainable exchange rate regimes are the polar extremes of complete fixity (through a currency board) or pure floating. Many shades and nuances remain between fixed and flexible exchange rates. My own tentative conclusion is that there is no general a priori superiority of a given exchange rate regime. For example, an exchange rate anchor proved useful for a number of small European economies (Austria, Denmark, the Netherlands, and Portugal). The crucial elements to bear in mind are the consistency of the overall macroeconomic strategy and the stability of the financial system.

References

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