Adam Posen: Fred Bergsten taught me long ago the best way to have a full turn out is some combination of intellectual food and salmon, and we’ve achieved that.

Anyway, I think according to my fabulous Blackberry, it’s almost 12:30. Now that we’re live streaming events, I’m trying to be more punctual.


We had an outstanding morning; I think you’ll all agree. The substance of discussion in both panels, our legal WTO-IMF panel and preceding that, our Economic Impacts panel, was terrific. I think, possibly in terms of headlines, but equally in terms of substance, we’re going to have an outstanding panel right now.

As I said at the start of today’s meeting, part of the point of today’s conference is to make sure that, not only do we have multiple perspectives functionally; legal people, people from the IMF as well as independent economists and market people. But to make sure that voices from abroad, from outside Washington, are strongly heard, not necessarily listened to slavishly, but of course, Washington shouldn’t be listened to slavishly either.
It’s my pleasure and privilege having worked with Joe Gagnon to bring together an absolutely outstanding panel as I think is why you’re all here. We have with us three of the current G-20 deputies from the Central Banking side and three colleagues of mine of longstanding. All of whom I admire greatly. That is Benoît Cœuré of the European Central Bank, John Murray of the Bank of Canada, and Luiz Pereira da Silva of the Banco Central do Brazil.

This gives you, I think, three important legs, geographically and three very different country or economy perspectives. None of these people are defined solely by where they sit. They are all economists and policy makers of great stature, and they will give their independent views, but obviously to hear a Brazilian, a Canadian, a European or rather Euro area official, carries a certain weight.

Now, to bring that all together, to have open discussion is wonderful, but then one needs someone who can handle and stand up with such a great crowd, and for that, I’m enormously grateful to Robert Zoellick for agreeing to be clean-up hitter on this panel, to use an American expression. All of you know that Bob Zoellick is one of the few people who can be both WTO and Global Financial Markets, both U.S. and systemic, and we’re very proud that Bob has been with us the last seven or eight months as our first ever, actually, distinguished visiting fellow. And so, thank you again, Bob, for joining us today.

We’re going to follow the same format we’ve been doing. I’m not going to give anymore bio because we’re more interested in their comments. Alphabetical order, we’re going to have Benoît, then John, then Luiz, and then Robert. Roughly 12 minutes plus or minus each. This is being live webcast. It’s being Tweeted. Tell everyone, “Come watch the Peterson Institute where the great issues are discussed.” And after their remarks, we will all have an open discussion with those of you in the audience. Thank you very much.

Benoît Cœuré: Well, thank you very much, Adam. Thank you for the invitation, and good afternoon to all of you. I’m very glad to learn that this is alphabetical order. Could have been decreasing balance sheets. Could have been increasing growth numbers, but anyway.

So, I would like to share a few remarks on currency wars. In so doing, I will take a simple banker’s perspective, so this will not be about WTO in any sense, and with that, it will be a perspective from Europe, meaning from a large central bank. So, it will be mostly about exchange rates between large currencies and not that much about emerging market economies, but I’m very confident that Luiz will address these issues.
So, the starting point here comes from economic history. It also comes from economic theory, and in a sense also from a political economy as a starting point in that policies that are efficient for the global economy are not necessarily optimal from the national standpoint, meaning that there is always a temptation to shift the burden and a cost of adjustment abroad and to maximize the net gains accruing to national residents.

So the starting point is that cooperative equilibrium are not the natural state of the world. We’ve learned that from the 1930s. Certainly, we’ve learned that from economic theory, and also this is a political economy or even human nature, if you want. So at the starting point, that there is always a temptation to divert from these cooperative equilibrium.

That said, what I would like to highlight in my remarks is that there are basically two approaches to exchange rate coordination’s. The first one is rather benign, and this will be my starting point, so let’s call that the 'let’s-keep-our-house-in-order approach'. And this will be basically that if exchange rate movements are the consequence of monetary policy decisions at home, aiming to achieve national objectives, then it’s broadly okay. It’s broadly optimal, and we shouldn’t worry too much about exchange rate movements. This is a dominant view today in the Central Banking community. I think it’s a relevant starting point and it's an irrelevant reference point, so to speak.

That said, there are risks that this benign approach to exchange rate coordination could not be sustained or would not hold for various reasons that I will try to highlight, so I will call that the 'let’s-not-kick-our-head-into-the-sand approach'. So let’s start from this benign approach, but let’s also acknowledge that there are situations where there are risks and that, once again, our risks of currency wars could be harmful to the global economy.

So beginning the benign approach or the case of no concerns about currency manipulation, the starting point is that typically exchange rate movements that arise from monetary policy shocks in various countries certainly do exert, spillovers on the rest of the world, but these such spillovers can be offset by policy measures in the other regions. So to the extent that the ability of other Central Banks to act is unconstrained, to the extent that their ability to offset these shocks is unconstrained, then currency movements arising from monetary policy decisions abroad are not that matter of a concern. And I think this is a right starting point. This is a focal point.

And this is, by and large, the environment in which the ECB operates. The exchange rate of euro is floating against major currencies. The exchange rate is not a policy target for the ECB. Certainly, it does matter for price stability and for growth, so as such; the exchange rate is part of our overall
assessment of the appropriateness of the policy stance. If contrary to our objective of medium-term price stability, it may trigger offsetting policy action, but it’s not a policy target, per se. And this is the basic [inaudible 00:08:07] in which the ECB operate.

Another important aspect of the consequences of the exchange rate movements is that, in so far as a result from monetary policy shocks, they bring about few tradeoffs for domestic monetary policy, and the basic reason is that currency appreciation generally tends to have the same effects or effects of the same sign, on inflation and on growth.

This is not the case for currency movements that do not arise from monetary policy shocks which has the potential to be more dangerous. But in so far as they arise from monetary policy shocks, there is very little tradeoff in term of monetary policy. And when you look at the empirical evidence and the [inaudible 00:08:52] effects of standout monetary policy shocks, you can see that, for instance, a monetary easing in the U.S. certainly brings down the dollar, but also it brings along a fall in the net export in the U.S., not an increase in net exports, but a fall in net exports, and a global output expansion.

So broadly speaking, for any other country than the U.S., the negative impact of currency appreciation and growth and inflation is partly or entirely offset by demand spillovers, by output spillovers. And this is another matter of no concern about the spillovers arising from monetary policy decisions. And this is very well documented in empirical results.

This argument should not be confused with another perspective or even an emerging perspective that you can find increasingly, in particular, in the editorial pages of the Financial Times, which have been very forceful about that, which I would call the Panglossian approach to a monetary corporation, which is that competitive devaluations triggering a [inaudible 00:10:01] towards depreciated currencies would be welfare enhancing. They would be welcome in the current environment because contrary to tariff law that is [inaudible 00:10:11] that is a negativism game; currency competition would just be instrumental in generating the needed, coordinated monetary expansion that would be good for large economies.

So basically, the story goes as follows: In the absence of a formal coordination of monetary policies, the currency wars can be a substitute for coordination. They can be a coordinating device that will deliver monetary expansion all throughout major economies. I disagree with that view. For us it rests on the assumption that monetary policy makers should do more than what they are currently doing and that currency depreciation would make up for perceived lack of action of major Central Banks, I don’t think that is the case. Monetary policy has been and is likely to
remain very accommodating in all major economies, so there is no need to substitute for lack of action by major Central Banks.

And also this Panglossian approach to coordination create difficulties of its own, and I will come back on that in a few minutes.

So that’s a starting point. A starting point is that in so much as exchange rate movements results from monetary policy decision [inaudible 00:11:28] aiming at achieving national targets, they are fine, and they are not a matter of concern. I think that’s right.

Now, let me list three reasons why there are limits to this approach. The first reason is more on the analytical side, on the intellectual side, when you reflect on the economy literature on international coordination, by and large, the literature finds only modest gains from international policy cooperation. We know that. I’m not going to quote all the papers but we know that literature is not enthusiastic about monetary policy coordination.

And as this consensus has been reinforced by the paradigm shift in international macro-economic theory, let’s say from a Mundell-Fleming Dornbusch to a new economy macro. And this is a prevailing consensus.

Now, when you look at the reasons and when you look at the assumptions under which this kind of result would hold, that there is no need for coordination, basically this works when Central Banks operate in a friction-less environment with only moderate macro-economic interdependence, and this is not the real world. This is an ideal world. [inaudible 00:12:46] has described this state as a state of divine coincidence where one policy instrument would suffice to achieve all targets. We don’t live in a world where one policy instrument is sufficient to achieve all targets. We live in a world with financial frictions, increasingly so. And we live in a world with very strong inter-dependences which reinforces the case for cooperation which creates [inaudible 00:13:14] gains from policy cooperation. So that’s the first argument, which is more an intellectual argument, an analytical argument.

The second argument I’m not going to dwell too much on it, that not all economies have been affected the same way by the crisis and this is an important difference from the 1930s. We all have in mind the comparison with the 1930s and the risk of non-cooperative equilibrium both in the trade domain and in the currency domain that we could see in the 1930s. But one important difference is that we have a group of large, systemically relevant economies, namely emerging market economies that have not been affected in a symmetric way by the crisis and this is an important difference.
And so, there is a risk, and there is a temptation, and there is a case for the economies to react to a monetary expansion abroad, not by tightening macroeconomic policies at home, but by fighting back against currency appreciation or by installing macro [inaudible 00:14:21] measures to stem capital inflows, and we know the discussion on the merits or lack thereof, of these restrictions. We know that there can be unintended distortions arising from these measures, but I will not dwell too much on it. I think Luiz has a comparative advantage in that field. I just wanted to flag it.

Also, we can have in mind the case of smaller, open economies, which have pegged their exchange rates to larger economies, and these economies have little room to react unless easing is undertaken in the own currency, and even with that, their ability to deliver domestic monetary easing to counteract the impact of monetary easing in their own country can be hampered by the lack of domestic assets available for [inaudible 00:15:09] easing. So they are in a difficult situation. That’s the second argument.

The third argument, which for me is the most important, is that looking forward. If you look at the situation of monetary policy in advanced economics, Central Banks in advanced economies are close to reaching the limits of their conventional policies or they have already reached their limits of their conventional policies, and they are already undertaking unconventional policies, such as for guidance or a constant easing.

If you think of a world where Central Banks would have to continue to expand their non-conventional policies, in particular if they had to expand their non-conventional policies to react or to offset the impact of currency depreciation in other large economies, then we may hit limits or we may hit difficulties. There are operational difficulties to additional and nonstandard measures. These difficulties are different in all regions, but they are operational limits, operational difficulties in all regions that can be [inaudible 00:16:15] of additional non-conventional policies on domestic demand, in particular in very leveraged economies, in particular in economies where [inaudible 00:16:24] difficult shape.

So there is an implicit cost in responding to further negative developments as an exchange rate appreciation would be in large economies. So this paradigm that exchange rates movements are okay because you always have the room of maneuver to react to exchange rate appreciation stemming from monetary policy decisions abroad, this may no longer be true if the ability to implement further nonstandard measures reaches the limit or is decreasing returns to the ability to implement non-conventional policies.

So, in certain situations, a Panglossian approach, this notion that a currency war, as a substitute coordinating device would deliver a
monetary policy expansion, this Panglossian approach would hit the limit, and in a situation where it becomes difficult to generate monetary policy stimulus in the domestic economy, then the Panglossian approach would only result in a global inflation bias. And that’s an important risk.

So in light of these constraints, it would be a matter of concern if large economies were to directly pursue competitive devaluation policies, in particular by resorting to large purchases of foreign assets. We would move from a positive sum game to a zero sum game. We would move to increasing policies to expenditure switching policies, which we know are a zero sum game, and this would pose serious risks for an escalation of trade and financial protectionism.

So the conclusion is the following: The keeping-one’s-house-in-order paradigm is a relevant starting point. This is a situation wherein there is no substantial matter of concern in the current situation, but there are some concerns that additional nonstandard measures would not gain enough traction on domestic aggregate demand, which would leave the exchange rate as the residual macro policy instrument to operate the stimulus of aggregate demand. And of such circumstances where the exchange rate would be the instrument and where [inaudible 00:18:44] would mainly operate as the external channel instead of the internal channel as a temptation to divert global demand and foreign capital to other domestic economy at the expense of other countries could be dangerously alluring.

So, the conclusion is that we still are in this benign environment, but are risks that we would move to a less benign environment with the temptation to use the exchange rate as a residual channel of monetary policy transmission. This is why coordination is much needed. Monetary policy coordination is in place. There is strong coordination or strong dialogue between central banks. There have been useful exercises, in particular in the G-20 framework to enhance cooperation in the international monetary system.

I have in mind in particular the CGFS work on global liquidity management, also the IMF work on the [inaudible 00:19:41] aspects of policies affecting global capital flows, also the recent E7 and G-20 statements. All of that is more needed than ever, and that will be my conclusion.

Adam Posen: Thank you, Benoît, for getting us off to such a rousing start. So we have now heard that an exchange rate policy is the last refuge of scoundrel central banker. So I’d like to now call on John Murray of the Bank of Canada, if I could please.

John Murray: I’d like to begin by thanking Adam and Joseph for inviting me today. This is certainly an issue that as a central banker, I care about, that as an
institution; the Bank of Canada cares about. I’m going to press a button, and hopefully, something will happen that’s supposed to.

I don’t want to bring down the mood after the rousing start by Benoît, but what I’d like to do today is share the results of some work that we’ve done at the Bank of Canada over the last few years, which feeds into, if not a solution to the problem, I can’t promise that despite the request of our organizers, but sort of underscoring the importance of finding a solution and trying to document, as we can, some of the costs of what’s been going on lately in foreign exchange markets and otherwise.

I call my first slide “Escaping the Prisoner’s Dilemma.” Here, I’m referring to the urgent need to rotate global demand, to accommodate, allow the deleveraging that’s required in advanced economies and greater reliance on external demand as a support for growth; and by turns, less reliance on export-led growth in emerging economies, some, not all, and increased reliance, one hopes, on domestic demand.

What we’re talking about, of course, is something that we’ve talked about for ages. The underlying asymmetry in the existing system, yes, but virtually all international monetary systems, starting with the gold standard, the dollar standard that followed it. And now the notion that, not just the notion, the reality, that deficit countries have no choice, but to eventually adjust, give way as it were, while surplus countries have the luxury of more time and resistance.

‘What I’m going to do, and this really started with modeling work that we began about three years ago with the start of the G-20 initiative. I want to bring this back to the G-20 framework and the notion of policy coordination within it and identify, I mean, the titles aren’t very creative, good solution, bad solution, ugly solution.

And what we’re using as tools here are two sets of global models that the Bank of Canada has developed. They’re actually an integral part of our projection policy analysis work at the Bank. We take them seriously. By that, I don’t mean that you should take the results I’m about to show you with absolute confidence and assurance. They are by way of illustration. But what I’m trying to say is that they’ve been carefully parameterized. They’re something that we use in our work, but of course, with all models, it doesn’t come with any guarantees. So take it in the right spirit.

What do we mean by the good solution? I must stress that this isn’t ideal. This isn’t the Goldilocks, but it’s good. And it embeds some key features of the G-20 framework that was enunciated in 2009.

First and obviously, some serious fiscal consolidation in most, not all, advanced economies. Secondly of course, meaningful deleveraging by
households and banks in many advanced economies. Third, structural reforms to promote growth in the advanced economies. This is all sort of good. Embedded in this third element is, of course, the important structural reform related to financial sector reform being conducted by the FSB. And then finally, structural reforms and exchange rate adjustments in many emerging market economies.

Now, I’m going to try and press on here, and hopefully, something should pop up. This is kind of the good solution. Suppose countries, starting on day one, actually started to do all four things as part of a joint commitment within the G-20 and pursued it in an animated way. The scenario we’ve got here is one, which I won’t try and describe all the moving parts, but a very important part involves a meaningful appreciation of China’s renminbi and a meaningful, real depreciation of the U.S. dollar.

But as was noted earlier, of course, we’re not just talking about the U.S. We’re not just talking about China. I’m giving specifics here in the chart for them, but it involves more, more countries at play. Here, we’ve got a 20% real appreciation of the [inaudible 00:25:27] and a 10%, roughly, real depreciation of the U.S. dollar. We also have the fiscal consolidation I talked about, the household bank de-leveraging, and some structure reform embedded here. Good solution.

This is kind of what global imbalances would do, out to the year 2020. This is a five-sector model, at least one of them, or five-country/region model – United States, China, Japan, Euro area, and others. And you can see the U.S. current account diminishes to about 1.5%. China’s surplus goes down to less than 3%. Things sort of moving intact. This is a good solution. Good solutions are good, but a little boring. Everything’s great.

Heavy costs of delaying needed adjustment. The bad scenario is one in which countries eventually realize they have to do the right thing, but they drag their feet on every front. Fiscal consolidation is delayed. Household bank de-leveraging is delayed. Structural reform is delayed. Currency adjustment is delayed in the EMEs by at least three-year period. The results are kind of startling. Now, I realize all of this is model-specific, but just to note here before I flip to charts three and four, the resulting loss, just through the delay by the model estimate, the loss in global GDP is roughly 6 trillion U.S. dollars, equivalent to roughly 8% of global GDP. That’s a difference between the good solution and the bad.

The cumulative loss in global output is about 16 trillion net present value over the 2012, 2016 period. Now admittedly, this is kind of what it looks like just in terms of the real effective exchange rate. All I’ve done here is delay by a few years the quotes needed appreciation of the renminbi. It later makes up for it, so this is simply a delay. If we didn’t allow the
model to work, it would blow up, perhaps kind of like the real world. So eventually have to let things that need to happen, happen.

This is a chart that shows the difference between a control solution, which is roughly at number one, and what happens to the world economy under our bad solution, green line, China in red, and the United States in blue. The U.S. in the simulation loses about 6% equivalent of the GDP level it would have through this delayed reaction. China, interesting in the simulation, loses 12%, and the world combined, when you add all the parts, as I mentioned earlier, it’s about 8%. Everyone loses. There are no winners in this.

Okay. Let’s get to the ugly. This is case where doing half the job could even be worse than doing none of the job or at least delaying the job by three to four years. Why does this happen? Because in the ugly solution, you get three of the four things or elements being done. You get fiscal consolidation. You get household and bank de-leveraging in the advanced economies. You get structural reform in the advanced economies. But you don’t get enough structural reform or exchange rate flexibility in EMEs to provide the bridge, the support. Because we know in the short run, the fiscal consolidation, the household bank de-leveraging, and even the structural reform, of course, are demand depressing. You need a bridge, something that’s going to support global growth from the short run to the medium run to the long run till all of these necessary things start to pay dividends. Not only do you need it as a bridge, but there’s an inevitability to it, that advanced economies have to rely less on domestic demand and more on external demand.

And EMEs, now again, I’m using these in crude, generic buckets as terminology, need to rely more on domestic demand because the old game is just played out. But in this case, because you don’t have that support, that rotation through more flexible, market-determined exchange rates that help guide the rotation, all you get are the depressing effects early on of the first three elements of the G-20 framework. And you get front-end loaded fiscal consolidation without demand rotation. You get a net present value and cumulative loss over the next five years equivalent to 17.6 trillion or 10% higher than the bad solution.

So there’s something worse than that, and it’s ugly. And it’s because the exchange rate adjustment in our simulations is that important as the support, the lift. And this is kind of what it looks like. The bad solution for the world, GDP, is in red. The ugly solution is in green. Eventually, the ugly solution is better than the bad solution. That’s because we enough demand compression, downward pressure on domestic wages and prices, the system does correct itself, however painfully, without the assist of exchange rate movement, but it’s a long, painful process. And in the
meantime, the cumulative world output loss from about 2011-12 to 2015 roughly, is much larger in the ugly than it is in the bad.

So where’s Canada? I mean, talked about China, talked about the U.S., Europe, and so on. And how the world could be good, bad, or ugly. What’s our interest in this? Well, we’re representative of the small, open, advanced economy community here. We play by the rules. We think we do. As many of you will note, though, that Canada was the first bad boy of the IMF, that we left the pegged exchange rates of Bretton Woods in 1950. We went back in 1961, but fell off the wagon again in 70 and have never regretted it.

A) We’re believers in flexible, market-determined exchange rates. B) I guess, as a subset of that unlike many others, we know and believe the exchange rate matters. It’s not of in-consequence. Interestingly, many of the people who maintain the exchange rate doesn’t matter are those that don’t let their exchange rates move.

Why we care, in part, is of course the externalities involved. Pressures from those who break the rules are displaced onto more flexible currencies, especially the small that can find their currencies moved in an outsize manner. The effects of persistent, large scale intervention and capital controls, we would maintain, differ substantively from those of quantitative easing. Exactly in the way as was described earlier, thinking particularly of Benoît’s nice presentation.

Persistent large scale intervention and capital controls differ substantively because they target the exchange rate directly and lead to what is inherently zero sum outcomes.

So you may ask, gave you three scenarios, so where are we, John? You started these simulations two, three years ago. Have you been tracking? If you track actual world GDP against what our models started to generate two, three years ago, so you’ve got some history there, you’re tracking just above the bad by a little. Does this mean that we are in the bad scenario as a global economy? Not necessarily because the world’s not quite that neat. We’re a little bit good. We’re a little bit bad. We’re a little bit ugly. Good; we have obviously had some fiscal consolidation, so it’s not like the bad in that sense. We have had some meaningful household de-leveraging and bank de-leveraging, recapitalization, restructuring in many countries. So that’s been progressing. In some cases, you might argue faster than desired. In some cases, slower than desired. But it has been moving.

There has been structural reform. I mentioned earlier the FSB’s work and the sort of very ambitious financial sector reform, but it’s beyond that. Many countries moving to liberalize their labor markets, their product markets. There’s an asymmetry here, though, often that you notice. It’s the
countries that, you could say, have to, countries under pressure, the deficit
countries that have had to be faster here and the surplus countries, once
again, that had the luxury of waiting or delaying.

So at least on those three fronts, we’ve moved. You can argue whether
nimbly enough, fast enough. So we’re a little bit good. In fact, we could
pat ourselves on the back. Maybe we’ve been fairly good. There has been
some delay though, so we’re a little bit bad, could’ve been faster. On the
fourth element, we’re not quite ugly either because there has been some
exchange rate movement and more recently, I’d say, more encouragement
on that front but perhaps a long time coming.

So in that sense, we’re not quite ugly, but of the four elements I
mentioned, you could assert that the one that’s been the most absent or
delayed or the least significant has been the fourth.

So what we’re seeing in the world, obviously many shocks at play, is kind
of an amalgam of these things. Progress on virtually all fronts, but of
varying degrees and having us track slightly above the bad towards the
good.

Here’s Canada and Brazil, the good. I’m not putting this up because I
suggest every currency needs to move by the same amount, and unless
they do, they’re obviously misbehaving. It’s just by way of showing,
looking at the Brazilian real how much they’ve moved since 2002 and
Canada, coincidentally, net by almost the same amount, by roughly 40%
real effective, and China too. China’s come up relative to this measure
2002 about 10% net and more recently. But is it enough? How much
should they have moved? There is a sense that, as indicated by the
reserves that have been accumulated and the capital controls, that certainly
there’s been resistance on certain fronts.

And again, I don’t mean to point the finger just at China, but there is a
form of inhibition, something that’s at play, if not subverting, certainly
inhibiting, delaying the adjustment process. Not facilitating as it might,
this needed rotation of demand globally that could certainly put us all on a
better path. It’s not a case of one country, if you take the longer view, and
doing a favor to others because the game we were on, the track we were
on, just not being sustainable.

We’ve done a lot more work on this, and if I haven’t bored you too much,
there’re some references at the end of my presentation our Governor,
Mark Carney, some colleagues in recent Bank of Canada reviews. And by
coincidence, I’ve done some speeches and I didn’t even realize it until
after I gave the speech, that the title “The Great Frustration” is actually
more apt than I thought. So I’m sitting there thinking, “Oh. Yeah.
Frustration. WTO.” So I’ll stop here, but thank you for your patience.
Adam Posen: That was really terrific, John. I kind of make a living telling people when central bankers are being nice but saying something. That was pretty strong language there at the end, in case you missed it. I would like to thank John, his colleagues at the Bank of Canada, for providing so much substantive input, so much work that is of common use. Obviously, once you put a specific model out there, it gets shot at, but it gives you the ability to really think about things through.

And I also want to thank John for giving us an idea of one vision of the scale of the problem. We thought we were putting Joe out there with some big numbers, but this is a whole other order of magnitude. I guess the final thing to note is that, especially by the time you get to the last chart and the word “frustration,” Canada and Brazil were separated at birth. Who knew? So maybe we’ll hear something very similar from Luiz Pereira da Silva of the Banco Central do Brazil.

Luiz Pereira da Silva: Thank you. Thank you very much, Adam and Joseph. It’s a real pleasure to be here and see so many friendly faces. Actually, Brazil was almost colonized by France. At some point in 1555, Villegagnon almost conquered the Portuguese colonies, so we could have become French, and I’m not sure it that was going to be better or worse, but …

Well, okay. So let me bring a sort of emerging market Brazilian perspective to the topic of currency wars. You know that Brazil is a very peaceful country. The only thing where we think a little bit about sort of more war-like type of behavior is when we talk about soccer and football, especially against France recently, which has denied us access to the finals of the last World Cups.

But let me sort of bring a little bit more of a political economy story about the current war and how emerging markets had to react to some of what Benoit and John were describing as difficult challenges even if it was done for domestic purposes.

Let me start with the crisis. Look. I think we all know it was really ugly. I mean, we were at the brink of a major collapse, but the G-20 leaders were prepared this time, I think having learned from the Great Depression and also from Post Bubble Japan, and pretty much, we used the whole set of the arsenal of macro policies that was available. And the good news is that we did manage to avoid, I think, a repeat of the Great Depression in the 21st Century. Using, I think, a whole set of weaponry, zero interest floor and bringing interest base rates to zero. Forward guidance signally that rates will stay low for a prolonged period of time, and of course also QE, the purchase of assets or quantitative easing.
So we definitely got all of us, into this new territory of unconventional monetary policy, especially in advanced economies. And logically, this was supposed to work. I mean, you had, like, balance sheet repair. You had very low cost of money. Spreads anchored to low level for a prolonged period of time. Liquid balance sheets in banks and firms. So basically, once you have all that, it was expected that you would have some recovery of animal spirits that firms and banks would begin rehiring and investing. And therefore, the recovery will sort of kick in. And remember that this was supported, it is supported by a huge amount of, let’s say, new literature, very sophisticated as you look at papers by Michael Woodford on using the SGEs and so on and so forth. And of course, like many commentators around, let’s say the press, like Paul Krugman and so on and so forth.

Now, it did work to some extent, but it’s taking longer than I think everybody expected. And why is it so? I mean, well, in emerging markets, we’ve seen this movie before. You don’t get out of over indebtedness just like that [snaps fingers], just because you sort of [inaudible 00:42:13] liquidity into the system and animal spirits just revived. There is a lengthy process of de-leveraging, the sort of process where it takes more time than I think we expected. And I think my personal view, particularly because many advanced economies are facing very deep issues about, let’s say more fundamental questions about the size of their welfare state, the way in which their societies are going to get organized around, let’s say the size of redistribution, of tax increases, of expenditure cuts, and sort of the future fiscal picture that would emerge from that, I think, will take some time.

And while it takes time, and while you still have some accidents down the road, like episodes of turbulence, such as the latest one in Cyprus. Well unfortunately, everything affects animal spirits and sort of gets again, this kind of roller coaster type of situations of false positives that we had in 2011 and 2012.

But the bottom line, continuing the story, is that, yes, if you look at [inaudible 00:43:26], if you look at forward guidance, if you look at QE, it did work, and it did save the world. Now, the only thing that we in emerging markets notice is that it did affect us as well. It had collateral effects on our macro picture. Because why? [Inaudible 00:43:43] I think everybody knows there was spillover effects of the pools of liquidity that were available. It wasn’t only us. I think John put a picture on the Canadian dollars, but if we had an Australian here in the room, I’m sure it would also sort of point out that the Aussie dollar has also got some pressure to overvaluation.

And we had sort of the liquidity pouring into emerging markets because of sort of the conjunctions of very positive pull and push factors playing out
at the same time. I think Rakesh did a report for the BIS here about a story of capital flows into emerging markets. I mean, it’s a full set of documents that we have illustrating what are sort of the unintended or the collateral consequences of the very aggressive policies that advanced economies had to take.

And even if you think that just a tiny fraction of these liquidities were pouring into emerging markets, consider the size of the balance sheet expansion of central banks in advanced economy, vis-à-vis, the size of the financial sectors in emerging markets. Even if you have just a tiny portion of it that constitutes carry trade or portfolio flows, it does affect financial stability and our credit markets at home.

So because of sort of the way in which you were seeing the phenomenon, a number of sort of questions about, okay, this was good because it had a positive effect on global activity, and therefore, spillover effects that were positive for emerging markets. Or was it, let’s say, because of the increase in financial risks that these liquidity poured into your guys’ equity and credit markets was threatening your own financial stability? Complicated questions because the two things, let’s say, play positive and negative roles.

There was a number of academic studies. The Fund, for instance, did a number of recent studies on the spillover effects. We, ourselves, tried to sort of construct a little bit of a more rigorous type of contrafactual study using the, remember the old [inaudible 00:46:18] tradition of constructing a model. You estimate the contrafactual. You estimate the robustness of the coefficients, and then you run the contrafactual and then you compare with the [inaudible 00:46:27].

Complicated stuff, but the bottom line is that—and the paper will be soon available. Look, our results, but I’m sure that anyone else can sort of, any other country can replicate it shows that, indeed, look, the intuition of people saying, look, it has an effect on equity markets. It has an effect on credit markets. It has an effect on creating a pressure for overvaluing, again, your currency, and it has an inflationary effect because of all these forces compounding already.

Demand did take place in Brazil. However, it’s also true that what was claimed by policy makers in advanced economies, and this was one of Benoît’s points, it did also produce positive effects on activity in emerging markets. So we were caught between these two situations. So what were sort of the challenges in terms of emerging markets policy of response facing these challenges and this dilemma?

We had, of course, at the same time, to take care of our own recovery after Lehman. And in order to take care of that, we in general, are very
straightforward, textbook contracyclical fiscal and monetary policy. But doing that, we got a very standard V-shape recovery, which produced also some overheating. So while we were recovering very fast, we had also to take care of the inflationary pressure coming from our own recovery in Brazil. Remember, Brazil was growing at a pace of 7.5% in terms of GDP at the end of 2010, which was clearly above our potential.

So, we had at the same time to take care of, let’s say, price stability and macro stability in Brazil in the process of our own recovery and at the same time to sort of deal with, let’s say, this additional exuberance, excess liquidity, credit, portfolio flows, coming from the policies that I describe as unconventional from advanced economies.

So what did you do? Well, very pragmatically, we used the combination of standard textbook aggregate demand control policies, monetary and fiscal. But we had also to compliment that with things that were necessarily geared towards, let’s say, reducing the risk of financial instability in Brazil. And those were what we called, let’s say, macro, or what sort of the new literature now calls, macro prudential measures. And they are very sort of standard as well. Bank reserve requirements, increased capital requirements in some specific sectors such as consumer credit market, and also some interventions in foreign exchange.

You know why? Well, because this was clearly a channel where that was being exacerbated in terms of the transmission of these capital flows and liquidity in a country like Brazil for, again, a number of reasons. For, let’s say, the yield differentials, for the quite sort of sound and robust macro picture that we had. So we had also to intervene. We took some measures to reduce, let’s say, flows in specific areas by imposing financial transactional taxes, and we were supported by some new literature by the Fund if you look at the papers recently produced by Jonathan Ostry and so forth calling for, let’s say, having concern about that.

Now. It worked. Of course, it worked. I mean, we have a central bank with reserves in Brazil, has the means to create situations where, let’s say, we can have a grasp on this excess liquidity [inaudible 00:50:49]. But it is important to acknowledge that there is no free lunch, that we had also to pay a price in terms of foreign investors’ perception of, let’s say, policy transparency and predictability.

And perhaps, in retrospect, it also affected our own animal spirits at home because we were facing this dilemma. We had at the same time to sort of take care of our own macroeconomic stability and take measures to do so and a constructed a framework of sound and predictable macro framework. But at the same time, take measures that were, let’s say, not necessarily as friendly as our previous sort of track record was suggesting.
And of course, I think personally, that after a while, it did affect market sentiment against Brazil. But the choice, although difficult, was necessary to present future risks of financial stability. I believe, personally, that this is over now. I think we are talking this little bit about the past. Things are now being sorted out. Brazil is now growing and recovering. We expect to see, for instance, a 3% GDP growth, and all our leading indicators of investments are now up. But I think we did pay a price for that.

So concluding, look, we have here around this table many, many people that participated in G-20 meetings. And are we capable of coordinating, let’s say, policy responses in these difficult circumstances? Think of the way in which we are sort of having a kind of laissez-faire pragmatic type of solution today. Advanced economies can continue having for; let’s say, to foster their recovery, unconventional monetary policies with QE and maintaining very low interest rates and also forward guidance.

And on the other hand, emerging markets are allowed to sort of do contravening measures that somehow and sometimes are aggressive, such as capital flows management and, in some cases, even capital control. Is this something that is globally welfare enhancing? Frankly, I think it’s probably something that does affect the animal spirits, both in countries that have to restore their own credit multipliers, such as the U.S. and Europe, and therefore have to sort of think of risk taking at home; and at the same time the animal spirits in emerging markets where investors see that, given the uncertainty, given the situation of, let’s say, still the large pools of liquidity, you might need to still have some measures that will sort of reduce the openness of a capital movement.

I don’t think it’s the case right now, but I’m just suggesting that the combination that we have right now, on the one hand liberty to conduct, let’s say unrestricted injections of liquidity and on the other hand the liberty as well to contravene that with capital controls, is probably not something that is optimal for the global economy.

So how to solve that, just to finish and then a quick word. Well, obviously coordination. Coordination, I think, is working at the level of the areas where you do have financial sector regulation and coordination, such as the FSB. I think it’s working well. I think you have to think of how to organize better the risk taking behavior of shadow bankings and banks in terms of cross-border flows.

But I think you have also to think at the level of the G-20. How some of the groups that John described and also Benoît described could sort of bring a little bit more of a dialogue. The dialogue exists. We talk to each other. But perhaps some more concrete steps towards having a combination in terms of how to combine the need for an expeditious and strong recovery in advanced economy with a little bit less of spillovers and...
the situation of sudden stops and sudden floods in emerging market that sort of disrupt the predictability and sort of the pace of emerging markets recovery. I think it is desirable to get closer to a [inaudible 00:55:35] type of solution at the global level.

So that’s our task. I’m not sure that it’s going to be easy of course; it’s difficult. But that’s what we’re going to be doing in the next few months. Thank you very, very much.

Adam Posen: Thank you, Luiz. I must admit that when we start hoping for the G-20 to achieve Pareto optimal solutions, my ability to make jokes gets deflated quite a bit.

But in all seriousness, it is a good and fundamental question to ask. If we can coordinate in financial regulation and if we can coordinate in times of overt crisis as we were discussing at the table in lunch, and there are people of good will who know each other and share a similar analytical framework, can’t we try to move towards something perhaps a bit more better for the world rather than happenstance? That question is unanswerable by me, but perhaps Bob Zoellick can give us an answer. Bob.

Bob Zoellick: Well, I want to compliment the Peterson Institute for taking on this topic. I think it’s a very timely subject, and I think it’s only going to become more so. So I think this is a conference that fits very well with the Peterson Institute’s tradition under Fred Bergsten of trying to anticipate economic issues that call for policy solutions, but also with the Peterson Institute’s future, because Adam has tried to encourage some very innovative research and debate that I think will contribute to anticipatory thinking. And I want to compliment Joe in particular. We’ve had some chance to talk about this. We’re really trying to push this issue forward.

I’ll make three points this afternoon that will span the past, the present, and a bit about the future.

So first, let’s put this topic in a historical perspective, and in this context, I don’t just mean Fred Bergsten’s and my experience. What some of the discussion has teed up is we’re still struggling with the unfinished business of the Bretton Woods Conference. Ben Steel at the Council on Foreign Relations has written an excellent new book entitled The Battle at Bretton Woods. And in many ways, it sets the stage very well for this discussion.

A Steel explains the prime architect for the U.S. position, Harry Dexter White, saw his aim as trying to create a new international monetary system to end the competitive currency devaluations and trade
protectionism, what the United States at that era thought were the twin scourges of the 1930s, perhaps different interpretations now depending on the dialogue we heard with Doug and Fred a little bit.

It’s also quite interesting in reflecting the times, the New Dealer Treasury was really focused on eliminating the old European powers as rivals on the world stage, and particularly they wanted to break up the Imperial Preference System of Great Britain. They wanted to elevate the U.S. dollar to surrogate gold, and one that has been lost sight of a little bit is they wanted to shift the focus of power for the country’s monetary system from Wall Street, which was their enemy, and the New York Fed, which they didn’t really appreciate, to Washington and the treasury. My favorite, of course, is the Bretton Woods resolution that called for the timely liquidation of the BIS, and of course, the BIS still exists and is going well.

Now in contrast, Keynes, who was the principal protagonist for White, had a different view about this monetary system, but it’s very applicable today. He wanted one that supported liberalized trade, but also tried to keep global payments and balances from emerging. And when they did emerge, allow them to be corrected with minimal economic pain.

Now of course, the core differences in perspective reflected the different national perspectives. The U.S., as a country with very massive reserves and a very big trade surplus, wasn’t concerned with global imbalances in 1944. And Britain, a country that was deep in debt with just a sliver of reserves and very uncertain export prospects, wanted the new monetary system to create a new type of international central bank that would encourage the growth of money globally, with mechanisms that would press surplus countries to either increase imports or appreciate their currencies.

As we know, Keynes and Britain lost that argument, so it was somewhat ironic at a G-20 meeting, I think in 2010, to sit there 66 years later and watch Tim Geithner try to revive Keynes’ logic with a proposal to establish a norm for current account surpluses of the G-20, which of course the Germans and the Chinese promptly shot down.

Now, I think there are four legacies of the Bretton Woods battle that we should recognize in considering today’s debate. First, both White and Keynes, despite their difference, treated the problem of reviving the multilateral trading system and eliminating discrimination in trade-depressing barter arrangements, which they saw as the alternative, as a currency problem, not a trade problem.

Yet, over the years, as you’ve heard today, we’ve let the global currency and trade issues become detached. They’re managed in different
institutions, the IMF and the WTO, and they don’t act with policy linkages.

There was a reference in one of the comments that this in the U.S. reflected the difference between the treasury and the trade people. I have to say, I’d never really encountered that in my experience. It may have been the periods that I was working on it, either in treasury or at USTR, but actually, there was quite a simpatico view. But there may have been different positions at different circumstances.

Second legacy. The international monetary and trade systems are still struggling with the re-balancing issue; how to share the adjustment between the surplus and the creditor countries, as John Murray’s presentation really highlighted.

Third; White’s key victory, the enthronement of the U.S. dollar interestingly survived much longer than his international monetary system. And that’s another irony, because if you look at what White said at the times, he couldn’t believe that the U.S. dollar would be able to play such a world role without the firm backing of gold.

Now, as Fred Bergsten has been pointing out, and I will probably point out in the future even more, this international role for the U.S. dollar, which everyone thinks is a great blessing, actually comes with two very big costs, and they are implicit in the discussion today. One, other countries can determine their exchange rate with the dollar and avoid appreciation by buying dollars. And second, one that’s a little bit mixed on the feeling on the U.S. side, there’s clearly a moral hazard for the United States that it won’t be pressed to adjust policies when it’s imbalances suggest that it should.

Now, the fourth legacy of the White-Keynes debate is a little bit different, but I think it’s quite important as underpinning this discussion. It’s the nature of a caution about intellectual constraints that are forged through recent experience. This is part of the description of Steel’s book that I enjoyed the most. Steel, in trying to describe Keynes’ positions, describes how, of course, Keynes came to age intellectually during the First World War and that much that was taken for granted in terms of the world’s political and economic foundations had just coming crashing down. And he mentions, “In particular, the gold standard, and with it indelibly fixed exchange rates seemed as natural to people then as it seems strange to them now.”

And he goes on to assert that the issue of replacing the gold standard with something else was as difficult and as fraught as the issue of replacing the dollar globally might be to us today. What was considered an absolutely extreme position, that of floating exchange rates, was considered by few
economists other than Lionel Robins, as a notable exception, to even be a system, as such that would be able to restore equilibrium.

So in sum, this topic is indeed discussing the unfinished work of Bretton Woods, and I suspect that the changes in the global economy will require us to consider some old intellectual strictures we’ve become comfortable with.

Now, my second point, a briefer one, is that I think there’s a combination of structural shifts going on in the global economy and extraordinary monetary policies that are going to push the topic of the international monetary system higher on the agenda. And I think Joe’s research details the recent record of currency intervention and trade imbalances. Obviously, this work will be refined, but I think this is the type of evidentiary work that will be very significant as people start to feel this in markets and other terms. So let’s just say a few words about the larger context.

Over the past five years, two-thirds of global growth have come from developing countries, and actually depending on how you count the numbers, that’s a low ball estimate. If you look as recently as the 1990s, that number was about a quarter or a fifth. Over the past decade, so now a much more recent period, exports from developed economies to developing economies have increased from 25% to 45% of developed country exports, and it’s actually 25 to 50% for the United States. In the 1990s, developed countries held almost 70% of the world’s reserves. Today, developing countries hold 70% of the world’s reserves.

So whatever norms that the G7 countries developed to manage this world of floating exchange rates after the breakdown of the Bretton Woods system, these may or may not be accepted by the principals in the new global economy.

And I was struck by Luiz’s closing point about how the process worked. This is where it is interesting to bring in sort of trade and central banker people together, much less the treasury types. It sort of worked, but if you actually consider the effects on the overvaluation of Brazil’s currency and you look at what happened in the Doha Round and I think most fair negotiators and observers of the negotiations would feel that put a real pressure on Brazil’s negotiators, particularly for their manufacturing sector. And even today, as you look where Brazil goes, you’ve got a very strong agricultural commodity balance, but what will be the effect on the manufacturing sector of some of these policy changes?

So was the price of these changes in this flexible exchange rate system an undermining of political support for a completion of a Doha Round? So,
yes, it works, but at what cost and price? And I thinks that’s part of the topic that we still need to get at.

Now, the other point is that the structural shift that’s taking place is coming at the same time that developed countries in particular, are still struggling to overcome the Great Recession. Understandably, an unprecedented crisis has evoked an unprecedented response, particularly from central banks. And monetary policy has been used fundamentally to limit tail risks and to buy time.

Now, I’m not saying, at least yet, that these extraordinary monetary policies have been misplaced, but I am saying that we’re clearly in uncharted territory. You look at the balance sheets of central banks, and we have not been here before.

And I understand that exceptional monetary policies, particularly those that are adopted primarily for domestic policy reasons and that are conducted in domestic currency, certainly differ from interventions of the exchange rate as a number of people have said today. But might the lines blur, as we were discussing in some of the other parts. So, let me just stick with developed economies for a second. We won’t even get into the tensions with developing economies.

How might a yen depreciation, because by the way, the Japanese Central Bank is not only buying yen denominated assets. How might a yen depreciation policy affect the Euro zone’s exports, particularly given their very similar manufacturing profiles at a time that the Euro zone is really struggling? And how would a competitive currency devaluation process between Japan and the EU then affect the U.S.? So what practical and political problems might be around the corner?

And there’s another aspect. If monetary policies lead to asset price bubbles that plant the seeds of more shocks to the global financial system, will the so-called management of the international monetary system be able to cope with the stress?

My favorite example, one that discovered a few years ago at the Kansas City Fed, was farmland prices in the U.S. Farmland prices in the U.S. are way above, in real terms, their late 70s highs. The money goes someplace. If you want to look at junk bonds, look at other assets. Now, there is always a justification logic for this. I’m not being critical of the policies, but I am saying we may face some unanticipated consequences, and how might those flow back into the international monetary system.

Now, third, as Gary Hufbauer and Jeff Schott and Vera and the very good panel from the legal side emphasized, the members of the WTO and the IMF have agreed to articles that offer multi-lateral standards for
addressing either manipulation of exchange rates or the frustrations, so I won’t get into the details; they already covered that. But at a minimum, it seems to me that the members of the IMF and WTO need to discuss what they mean by these articles. They’ve agreed to them. Don’t we have to have some sense that they might mean something?

And I personally think this is where, when we think about policy actions, it’s important for the head of the IMF, in particular, but in concert with the Director-General of the WTO, not to abdicate the responsibility to pose these issues. This is a governance question. There is a role for international leaders of these institutions to at least push the discussion, even though it may be uncomfortable, maybe you can’t get board decisions. But there are lots of things that the leaders of multi-lateral institutions can do, short of board votes, to at least frame the issue. And reason why this is important is because if multi-lateralism fails, unilateralism will prevail. The issues will not go away. People will take alternative approaches to them.

Now, I think there’s an important role here in the international system to try to anticipate some possible problems. I think Mike [inaudible 01:10:15] presentation was a way of trying to touch on that about sort of interpret them.

Gary Hufbauer posed a question based on something that I’d written in a Wall Street Journal Op Ed, and just conveniently today, the FTE published one that I wrote about the next head of the WTO, where you can see I’ve been consistent. And it’s interesting, you’ll see one of the points that Gary touched on was that all the WTO candidates have now said, or at least he believes that as they campaign, they’ve been downplaying the role of the WTO in currencies. Well, I obviously suggested that that ought to be a question that maybe some other, maybe Brazil and the U.S. and other ought to ask candidates, so at least the next WTO Director-General starts out with a fair sense that this issue should not be totally off the table.

I also think that one of the problems of the problems profile will now only be exacerbated by these issues that I mentioned of structural shifts, the response to the Great Recession, extraordinary monetary policies. And you can’t avoid it; there’s a rising debate about competitive devaluations. Now people may mean different things. I’ve never liked the currency war concept. I think it engages in sort of hyperbole about the difference between real wars, which I’ve seen, and this type of issue. But the reality is, the topic, I think, is present at the table, and we ought to figure out some way to have an informed discussion, particularly from policy think tanks, but also the international institutions.

And it was interesting. Luiz’s sort of response from the IMF to Joe’s research. My takeaway was, you may differ in matter of degree, but you
don’t differ in terms of the fundamental substance about the connection of the intervention with the current account surplus. And that’s, I think an important point. So I think this is opportunity for the Peterson Institute and others to try to offer some ideas on policy responses and strategies to nudge the multi-lateral system to achieve them. Now, I wouldn’t expect steps as bold as some of the ones that Vera was talking about to try to explain it. But I do think it’s important to try to recognize the interconnections.

I was at a G7 meeting of finance ministers a couple years ago, I was actually hosted in Washington by the Canadians, where among G7 countries, there was an effective reestablishment of the norm among G7 countries that thou shalt not intervene unless the other G7 countries concur that that’s a basis. Well, that’s not a rule. It’s not written down anywhere, but it was a norm of practice. One of the countries had taken some action that sort of raised some question, and the discussion basically reestablished that. That’s one start of the basis of these types of actions.

I think this type of research again, I think, could lead, whether in the multi-lateral institutions or at think tanks to say, “Well, what are some of the indicators, whether it’s the reserves, or frankly, if you’re in a small economy, might you have different circumstances? These are very important topics to at least have a more informed discussion on.

My guess is, if anything will be done more significantly on it, it probably won’t be done at least in the first order by litigation. But it will require the major economies to start to push harder. Now, I don’t want to get too far ahead of Fred Bergsten. There’s different strategies Fred and others have been thinking about. Not the least of which could be U.S. intervention policies. The U.S. may want to intervene to counter some other actions on some points. Not that that would be the solution in and of itself, but the point is trying to avoid letting the issue sort of just be sort of lost in the legal terminology.

As people have discussed today, I think while some of the big economies may need to start the discussion, you probably to be effective, you have to create a new mini-lateralism. You’ll have to create a group of countries. The U.S. and Brazil might be not a bad starting point in some these issues. And they’ll have to build a coalition, and ultimately, if you’re going to be effective, you can’t try to isolate somebody.

So China’s come up in the discussion, but please recognize Governor Zhou, in fact President Hu also, was talking about the need to change the international monetary system. So there’s actually language that they’ve talked about that a dialogue might be able to build some sense of commonality of purpose with these issues. Continue to be nudged by some of these other tools. And I think there were some interesting ideas about
how sort of multiple legal actions in the WTO, if it came to it, might sort of push and compel the issue. I think some of the ones on the macroeconomic side, including U.S. intervention, might be a quicker place to try.

One last point about this. You will see how this affects the policy and the politics. But just thinking a little bit about how those fit together, it’s something I hadn’t thought about until I came here today, but I know Ted Truman has been working on the IMF quota increase and got a nice editorial over the weekend in the New York Times. One possibility if the Congress gets engaged in this is that when they do the quota increase, as I hope they do, they might put some language in that about trying that the U.S. needs to pursue some of these topics, at least as a will of Congress in the process.

Remember, the reason we got the currency manipulation language in the 1988 Trade Act was, frankly, Congress trying to join the bandwagon that had partly been launched by Fred Bergsten and picked up by one of my bosses, James Baker, in the whole currency effort with the G7 and a recognition that the language of currency manipulation obviously comes from the history of these documents, was that Congress was trying to engage in the game through its own legislative process. And remember that 1988 Trade Act was an authorization of trade negotiating authority. That was the fast track. And it came with a series of process steps as well as this language.

Now, by the way, there’s a discussion in the United States at the same time it’s going to go ahead with trade agreements about trying to get trade promotion authority. So might you see language like this show up in trade promotion authority along some point too.

So I think what this discussion has been particularly useful for is trying to combine a little bit of sense of that the problem that we’re struggling with is not an easy problem. And my point about going back to Bretton Woods is that this has a long history and legacy, and people have struggled with it. So we shouldn’t feel we have to come up with an answer today. But on the other hand, we should realize that this is a problem that won’t go away, and we’re not serving the international system by abdicating it. And the question is, what sort of combination of changing people’s attitude and outlook, seeing the risks of inaction, what combination of multi-lateral discussions, and what combination of either unilateral or group action whether in micro-economic or macroeconomic terms, might push the international system to a better policy equilibrium than we’re at today? Thanks!

Adam Posen: In hopes of allowing the system to evolve, I didn’t do quite as tight surveillance as I sometimes do. So we’re very short of time remaining. I
would like to ask our four speakers if they’re still willing to come up, to have a seat, and I will ask for a question or comment from the audience. Given the quality of these statements, I hope it’s a good question or comment.

As is our new habit I’m going to ask the first couple questions or comments come from the guests we have here, rather than from in-house, where obviously, Bob as well as everybody else is well rehearsed in what we have to say. I’ll just sit here to direct traffic. So who would like to volunteer? I see someone leaving because he didn’t get ask a question. Okay. If no one else volunteers, I do know there are Institute people who would be happy to open their mouths. I see a lady in back, yes please. Come to the microphone.

Jennifer Harris: Thanks. Question’s quick. What are your-

Adam Posen: Please identify yourself.

Jennifer Harris: Jennifer Harris, U.S. State Department. Views on introducing currency questions, possible responses within current trade negotiations, such as TBP or [inaudible 01:18:40]? Thank you.

Adam Posen: Okay. What kind of linkage would people want to make, would advise the U.S. or fear the U.S. or desire the U.S. to do as it pursues these regional trade negotiations? I’m not going to let Bob go first. Are all the other ones scared to mention on this topic? Okay, then let Bob go.

Bob Zoellick: Well, it’s interesting you asked this because I just discussed this with Fred yesterday. My overwhelming thought in this area is that we need to have real negotiations before we figure out things to add into them. So we need a U.S. trade representative. We need the will to take on these tough issues, and there’s a lot of work to be done in the TPP, and the transatlantic hasn’t even been started.

So, my first inclination is, let’s kind of get the basics going and moving ahead without necessarily complicating with this issue, but I would say that in the transatlantic, U.S. context, it might be useful to at least discuss its process of building this sort of broader coalition whether European Union and the United States would like to emphasize a norm. In other words, my thought here is, we might not have enough homework done to try to have something that would allow retaliation or trade action or something like that.

But I think if you’re going to build a broader coalition to discuss this subject, my sense is, is that in the past decade, this has been seen as a U.S. problem with China, and I personally believe that that’s a mistake. I think this will affect the European position. You can see, as John’s comment
about how other flexible currency countries, Canada and others, are affected by these imbalances and the failure to rectify them.

So I think that if types of discussions like this lead people to feel that this is sort of a gap in the international system, while my preference would be to have the IMF and WTO play the key role, they may need to be prodded through some of these other discussions. But at early stage, sometimes in the trade negotiations, we don’t always have to run to dispute settlement systems.

Adam Posen: That’s a good point. I see one more person in back. Oh, sorry. Please. If you’re willing to talk, please…

Luiz Pereira da Silva: Just a footnote on this as well, complimenting what Bob was saying. It’s also important to think of global imbalances within a trade zone, within a monetary common area. Think of, let’s say, what could have been done, perhaps, within [inaudible 01:21:25] to accelerate trade integration. We are not at sort of the stage of, for instance, the Euro zone, but even in the Euro zone, you could have thought of, let’s say, better ways in which you could sort of reduce or moderate imbalances between countries with surpluses and countries with deficits.

And I think it will help also, in the context of, let’s say, improving trade, to have also a view of, let’s say, setups that would create more cooperative behaviors within, let’s say, trade. I think we all have problems, and I think we need to seek at home and internationally solutions that are cooperative.

Adam Posen: Does that provoke Benoît, or no?

Benoît Cœuré: Well, I can add a footnote to the footnote. Now, I certainly agree with Luiz that the regional dimension is important, well, especially within a monetary union, but also when regional exchange rate matter. But it’s not that much about tariffs than about market integration, I would say. What we’ve seen in the Euro area is that part of the reasons for the current mess, if I may say so, is lack of market integration. Not that much from manufactured goods, but for services. We don’t have a properly functioning single market for services. We have financial fragmentation, which is about a single market for services, financial services. So financial integration does matter a lot at the regional level.

Adam Posen: Okay. There is a gentleman I see back there who can go to the back mic, and then because not enough of you volunteered, Ted Truman gets to talk.

Audience 2: Thank you. [inaudible 01:23:00] with China [inaudible 01:23:01] Agency. I have two questions for Ambassador Zoellick. The first one, and economist from the [inaudible 01:23:09] San Francisco release a study
report a couple days ago, predicting that Chinese economy growth rate will-

Adam Posen: I’m sorry. That’s not on the topic of today.

Audience 2: Okay.

Adam Posen: Do you have a question on the topic of today?

Audience 2: Second question. China is stepping up to side a currency swap agreements with many other countries. Are you concerned about that the U.S. dollar’s dominant status internationally will be threatened?

Adam Posen: I don’t think that’s really anything to do with today either, but since Bob, if you want to say something quick…

Bob Zoellick: Sure. No, no, no. That’s fine. No, I’m not concerned about the dollar. If anything, as you see the problems with the euro, that, I mean, it’s—the dollar’s preeminence’s, in some ways, reemphasize. I think, I’ll defer to Fred and some of the work he does as I touched on it. This is a double-edged sword for the United States, in terms of the reserve currency. So, my own sense is, is that over time, I do not know how long, but over time, you are likely to move to some multiple currency and maybe even multiple asset system. And it maybe, we’re now probably talking decades, but in the spirit of this discussion, I think these types of topics are the sort of issues that should lead the IMF as well as the WTO, to start to discuss what would be the relationships and implications as you move to those systems.

One last point is that I think China’s swap arrangements are also one step in the efforts of Governor Zhou and others to internationalize the renminbi. And I think the process of internationalizing the renminbi is related to China’s goal, its own stated goal, of opening the capital account. And once China does reach the stage of opening the capital account, then I think the topics that we have on this table will even be of greater importance. So in that sense, I think all of that is a positive step.

One last point though. The concern that – just having read Ben Steel’s book again, is, is that you don’t—one of the problems in the 20s is you started—you didn’t have barter arrangements, you have bilateral currency arrangements. I mean, in effect, this is what the imperial preference was with Britain too where you had sort of pounds that can only be used to buy things from Britain. So it will be important as you move toward these swap arrangements that they be fit within an international currency system, in that we not allow the system to fragment, which just underscores the point to me, these issues are not going away.
And frankly, I think that, you know, there’s a key role here for the IMF and WTO to at least get them discussed and hopefully drawing from some of the work on places like the Peterson Institute.

Adam Posen: Okay. I actually have a comment, but I’ll withhold and defer to Luiz who wants to come in.

Luiz Pereira da Silva: Again just a footnote. As you may know, Brazil and the Central [inaudible 01:26:15] and the People’s Bank of China just signed, last week, a swap agreement in Durban at the fringes of the BRICS Summit. It’s a $30 billion dollars line. The objective is precisely sort of facilitate, let’s say, trade if there is more adverse conditions in terms of market sentiment in the global economy. So it sort of compliments existing mechanisms. It’s supposed to precisely facilitate the great amount of trade flows that we have between our two countries in case there is an emergency. I think it’s mechanism we have similar swap arrangements and mechanism with other central banks. It provides, let’s say, a sense of better insurance and better sort of conditions for continuation of global trade if there is sort of a more adverse conditions in terms of international financing lines.

Adam Posen: Thank you. Benoît?

Benoît Cœuré: No. To follow up on what Luiz just said. I mean, currency swap arrangements and also payment links on a more technical ground, it’s a little bit the tail that wags the dog. I mean, it would be an illusion to think that you can steer market integrations with these kind of arrangements. So swap agreements are fine as facilitating, as Luiz just said, facilitating the development of trade and investment flows, but it has to come from the market. So it’s fine to facilitate a market-driven development. So the ECB will be ready to do that if there is demand from the market. If there is no demand from the market, we won’t do that.

Adam Posen: Let me just, since my colleagues were good about linking this back to our main topics today, let me make just two points.

One is, unfortunately, I think the question reflects this false over-exaggerated rhetoric about currency wars that several of us have mentioned. As serious as this issue is, it is really not necessarily a zero sum issue, and it should not be over-dramatized in those terms. To my knowledge, there is no U.S. official in the current administration or in the previous administration and I think others could correct me if I’m wrong, who has in any way looked down upon China or Brazil or the Euro area pursuing bilateral swap agreements, pursuing greater depth of ties, pursuing greater liquidity in their markets. This is viewed as better for the system as a whole.
More broadly, I’m actually going to differ with my friend and colleague Bob Zoellick in a slight way, which is in a lot of ways, as our Advisory Committee Chairman, Barry Eichengreen has argued among others, we are already into a multi-reserve system. Not because the U.S. dollar isn’t dominant in trade invoicing in official reserves, and so on, but because a larger and larger number of countries are able to issue debt in their own currency. A larger and larger number of countries are able to see their interest rate premium versus the U.S. go down. A larger and larger number of countries are able to pursue monetary independence rather than being forced into a fixed exchange rate arrangement, which was implicit in a lot of the things we spoke.

And that suggests, in my view, just speaking for myself, sort of in line with something that John was saying in comparing the bad and the ugly, the time of greatest danger for this issue is the next few years. When we reach a point that China, Brazil, Latin American currency markets in general, have all returned to greater depth and greater strength, or have achieved greater depth and greater strength and the Euro area has returned fully to the role we hope and know it should, then this issue will be smaller because, in the same spirit as Luiz said earlier, well just imagine how big these spillover effects are on our tiny balance sheets. In a world of deeper, more locally denominated currency markets, more independence, those effects will be smaller.

And so I think the actual point of maximum danger on this issue, which is part of the reason I supported Joe and others in doing this project, is in the next few years.

I’m going to let Ted Truman have a word since he patiently waited.

Ted Truman: Thank you, Adam. If I may speak as a relative elder spokesman here. I think this has actually been an unusually interesting and successful conference. You and Joe and Fred and the other participants should be congratulated.

Adam Posen: Thank you.

Ted Truman: I guess I have three questions, none of which are for Bob, just three.

One is somewhat provocative. Benoît said and I think, and Luiz implied that nonstandard monetary policy measures are having no effect, that the income effect is disappearing, and it’s all exchange rate effects on other countries. And I’d be interested in what evidence you have for that. That’s a fairly strong statement. It’s conceivable, but I don’t think there’s much—my sense is there’s not that much [inaudible 01:31:11] to that.
The related aspect of that, it seems to me is really more for Luiz, but John and Benoît may all have views on this, exactly what would you have had the G-20 do with respect to the Federal Reserve or the Bank of England or the Bank of Japan today in terms of making this better. I mean, we need to know some of what would you do, it seems to me.

And last, if I may put Benoît on the spot, looking over Joe Gagnon’s shoulder. So one of your close neighbors, i.e. Switzerland, has been one of the more aggressive countries in the last several years, the last five or six years, in using the exchange rate instrument to maintain its current account. And so what should the system as a whole think about this as a device? I mean, does this, admittedly Switzerland is only the home of the BIS and not part of the G-20. I guess part of the G-20 FSB. I think that’s a—I mean, there’s an example of a major industrial country, actually the only major industrial country in the last five or six years that has used intervention as a major tool for monetary policy purposes. So how should we, or how do you, or how should we think about that? I’ve given you enough questions, so you can duck them all.

Adam Posen: Wow. I thought we were going to be quick, but they’re all very good questions, I must admit. So, why don’t we let Luiz start off, since I think he was the only one who had all three questions directed to him. And then we can let Benoît go last to make up what he’s going to say.

Luiz Pereira da Silva: Okay. Quickly, Ted, look. On the spillover effects of UMP, there is a bunch of new literature coming in, in terms of evidence. It’s sort of standard contrafactual type of literature. You have Pesaran and Smith studies for the UK. Basically, the idea is to look at the effect of the term spread on, let’s say, other variables that you have to model for your domestic economy and see if you have a contrafactual in terms of what the term spread of, let’s say, advanced economies behave, and you have a good model to predict both, let’s say, the actual outcome and also the contrafactual outcome. Then, by difference, you can measure for a bunch of, let’s say, other variables, what is the net effect in equity, credit, and so on and so forth in your domestic economy.

A bunch of studies that are coming, I think it’s—the point is that, again, we are not sort of finger pointing anyone here. Remember, the message here was try to find cooperation and not sort of …

But I think it was important besides some of the studies that the Fund has put out to have, let’s say, some common methodology that would say, “Look. Hey. This had, if you measure it with this kind of methodology, effects A, B, and C. And then we had to react with, let’s say, X, Y, and Z types of policies.” No judgments taken. Just a sort of observation of what was the effect in terms of additional capital inflows if, let’s say, the term
spreads wouldn’t have been what they were in terms of, let’s say, lower absolute level?

G-20, the role of it. I think, look, we have a bunch of people here around the table, who participated in these meetings. It’s the unique place where you can have, let’s say, almost the kind of discussions that we’re having here, very frank, among policy makers. Now, it’s not ideal. Some of the decisions are, of course, subject to the political economy of this world. I mean, I’ve seen the latest papers by [inaudible 01:34:57] about the relationship between reforms and politics.

I mean, I think we all understand that—I mean, you’re the first one to sort of- I cannot sort of compete with you in terms of policy experience, Ted. So people realize that there are constraints in terms of the analytical framework that is ideal and Pareto optimal and, let’s say, the results of the political economy of the time. I think if we’re capable, let’s say, sticking to some sound principals in terms of analytics and at the same time understanding well the limitations of your own political economy, then you are, let’s say, working for, let’s say, a better world at the level of, let’s say, institutions such as the G-20. So it’s sort of, kind of not ideal, but I think that’s the best we have. And I leave the Swiss franc for Benoît.

Adam Posen: Oh. Before Benoît goes, John, you’ve been very quiet. Do you want to say something?

John Murray: That’s not necessarily bad. I don’t know that I have…

Adam Posen: Spoken like a true Canadian. Yes. Okay.

Benoît Cœuré: Before answering to Ted on [inaudible 01:36:05] G-20 decisions are, by definition, Pareto optimal because [inaudible 01:36:09] consensus. So the point is that they are not socially optimal. That’s more worrying. But, well, that’s [inaudible 01:36:17].

So on Switzerland, well, I would say that the acid test for me is the kind of spillovers that any given policy exerts on the rest of the global economy. And I don’t have evidence of negative spillovers that would be exerted by the Swiss interventions. We are not worried by the Swiss interventions. We don’t see negative spillovers on the Euro area. Do you see negative spillovers in Canada and Brazil and [inaudible 01:36:44]? So it’s okay as long as it doesn’t create- as long as it doesn’t disturb the other regions.

There have been talks, for instance, that by buying Euro dominated assets, Switzerland would suck out collateral from the Euro area. We’ve seen that in some IMF working papers. I think that’s not right. We don’t see that kind of effects. So we don’t see the negative impact. So that’s fine.
Adam Posen: Just on this point. Thomas Jordan, who runs the Swiss National Bank is a friend and colleague of many of ours, and I’m hoping to have him or his representative, I’m sure he’ll be willing, we just haven’t set it up yet, come explain their views on this podium in the not too distant future.

I would just have to ask, for the record, Benoît, one question. Well, two questions. I personally, as I said in the press the other day, am very sympathetic to the Swiss National Bank’s situation with the capital inflows they face and with the fact that they are undertaking other macro-prudential measures to try to offset similar to what Luiz described from Brazil.

But I also said that, for me, the acid test is a little different. It is will they maintain the peg when it ceases to be advantageous for their exporters? Is it truly driven by financial stability? I’m not going to ask you to comment on that. But so just two quick questions.

First is general in the IMF articles, as I understand them, you have exchange rate pegs by bilateral agreement between the pegger and the peggee. As far as I think most of us are aware, there has been no announcement of an agreement between the ECB and the Swiss National Bank. Is that correct?

Benoît Cœuré: Mm hmm.

Adam Posen: Okay. Second is, this is more a research question, maybe for Joe or for some of the bright younger people on our staff. It would be an interesting question to think what is the criteria or the cutoff of Benoît’s comment? Is it just size? Is it interconnectedness? And then add up who are all the countries who might reasonably meet that criterion? And then if in total they matter. Just as a legitimate empirical question in the same spirit we’ve been pursuing all day. Sorry to end on a research [inaudible 01:38:54] No, you get last word. Please.

Benoît Cœuré: No, but that’s just for the sake of answering Ted’s other question on nonstandard measures. So my point was not to make a statement on the current effect of nonstandard measures. What I wanted to do is to flag possible dangers, looking forward. So it’s a warning about the dynamic effects of the kind of non-cooperative equilibrium where all central banks would have to inflate again and again their balance sheets, and then I’m convinced that, at some point, it would hit limits in terms of operational feasibility or in terms of efficiency.

I don’t want to speak for the Fed or for the Bank of Japan. I can speak for the ECB. I don’t see a scope in the Euro area to engineer the same kind of balance sheet expansions through outright purchase that we’ve seen in the US or say in the UK in the face of fragmented financial markets, in the
face of a less deep and liquid mortgage markets, etc. So I don’t think is a valid option, looking forward, to cope with possible exchange rates depreciation in other countries.

Adam Posen: Thank you very much, Benoît. I am going to cut off there. We’ve, in very rare form, gone way over our time, but I think that is a tribute to the kind of frank and substantive discussion, not only these four senior states people, but everyone who engaged today was here and that all of you stayed to stay with us through this was a terrific tribute. I want to thank, in particular, Benoît, John, and Luiz because, of course, they unlike Bob and I have a great deal of official constraints. And for them to engage at this level of intellectual depth, I think, is a real treat. We knew they were capable of it, but the fact that they were willing is a real terrific thing. So thank you very much for that.

And then, in particular, there’ve been so many people, Yvonne Priestly and the meetings team here always does an excellent job, but for various reasons, this was a difficult one to run, and they did it beautifully. Jeff Cordeau, our Director of Operations; Michael Ennis, the man in back who makes John’s PowerPoint come to life; Lucio, Vera, our colleagues from other institutions who helped us bring together this focus; but most of all, a special thanks to Joseph Gagnon who has, I was proud in a sense that he was—Fred and I hired him when I left for the Bank of England. He’s been a great, great colleague, and for him to take the lead on this was just another thing he does for the Institute and really high praise to Joe for putting this together.

Thank you all very much.