Comment on Richard Cooper, "A Century of Central Bank Cooperation"

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It is a pleasure to be here in Basel, to attend this fine conference at the BIS, and to see so many old friends. It is also a pleasure to have the opportunity of commenting on this paper by Richard Cooper. If you know Dick, you know that he is a stickler for definitions. Ask him to comment on a paper on the renminbi's undervaluation, and he will question the author's definition of "undervaluation." Ask him to comment on a paper on current account sustainability, and he will question the meaning of the term "sustainability." So it is only right that I should question what the author means by "central bank cooperation." In fact, Professor Cooper doesn't provide a definition; rather, he provides a series of examples: information sharing, standards for information gathering, coordinated policy adjustments by central banks. Although illustrations are helpful, an explicit definition would still have helped to focus thought. But what I miss even more is an attempt to prioritize these forms of cooperation. Are some more productive or important than others? Are there some that we should be particularly concerned to promote?

The paper is organized as a series of vignettes in central bank cooperation, but they are vignettes without a theme. Is it the author's view that central bank cooperation has been growing more extensive over time? Or does Cooper see cooperation between central banks as, alternatively, rising and falling – as passing through a series of cycles? My own view is that there have been ups and downs: the 1920s was an up, the 1930s was a down, the 1980s saw more systematic central bank cooperation than the decades immediately preceding and succeeding it. But the broad trend nonetheless has been upward.

Assuming that the author agrees, one would then wish an analysis of why. I can immediately think of three hypotheses that might explain why central bank cooperation has become more systematic and extensive. The first one, alluded to in the final paragraph of Cooper's paper, is that the costs of information sharing have declined with the advent of jet airplanes, trans-oceanic telephones, and the internet. A second explanation is that cooperation has been increasingly institutionalized. Naturally, this is the preferred explanation of aficionados of this bank. Institutions like the BIS have provided a venue for the regular exchange of information, the sharing of expertise, and the harmonization of world views. One interpretation of the obstacles to central bank cooperation is that cooperating requires solving commitment and coordination problems. Institutions like the BIS are mechanisms for diffusing information on the actions of central banks that make reneging on commitments unprofitable. They help central bankers to identify focal points useful for solving coordination problems. They thereby facilitate regulatory harmonization and the adoption of compatible monetary policies.

A third explanation for changes over time in the extent of central bank cooperation is whether monetary policy makers in different countries share a common world view – whether they have compatible models of the operation of the economy. I find this explanation appealing because I was convinced by the author's classic article on cooperation in public health as a metaphor for central bank cooperation.[1] (The argument there, you will recall, was that the public health authorities of different countries could agree on an effective policy for stemming the international spread of infectious disease

[1] See Cooper (1989).

only when they possessed a common model – the germ theory of transmission in that instance.) Thus, I was surprised that the compatible-model explanation for the rise in central bank cooperation is missing from the present paper. One can make compelling arguments that the rise of a common monetary policy paradigm – namely, the belief that independent central banks should target low and stable rates of inflation and pursue other objectives only to the extent that they do not conflict with this core mandate – is a key explanation for their ability to cooperate. It is hard to believe that the EU could have established a European System of Central Banks had there not been agreement on low and central inflation as those central banks' primary objective.[2] Similarly, the success with which central banks and regulators have harmonized their policies toward capital adequacy reflects a common understanding of the role for regulators and a common acknowledgement that we now live in a market-led financial system.

I can imagine two ways of understanding this omission. First, Cooper is worried that agreement on a common model may not be conducive to constructive cooperation in the event that the model is wrong. My favorite example of this phenomenon, predictably, is the 1930s, when central banks were wedded to a retrograde model of the gold standard. League of Nations conditionality, Kemmerer missions, and the Bank for International Settlements all encouraged them to adopt a particularly rigid and fragile version of the gold standard and then to cooperate in its maintenance in the face of the fiercest deflation of the 20th century. It can be reasonably argued that the late 1920s and early 1930s might have been better without this counterproductive cooperation. Cooperation is only helpful, the conclusion follows, when it is cooperation in pursuit of a sensible goal.

[2] Indeed, in Italy the Northern League's questioning of this priority is, for better or worse, the most articulate challenge to the hegemony of the euro and the ESCB.

The other explanation derives from the fact that the current hegemonic model of central bank policy – flexible inflation targeting – encourages central banks to focus single-mindedly on inflation and suggests that it may be counterproductive for them to divert their attention from this core mandate by cooperating in pursuit of other objectives.[3] This is a case where agreement on a common model is not conducive to cooperation.

A final point is that it may not be appropriate to pursue central bank cooperation in isolation from cooperation with other policy authorities. In some circumstances, monetary cooperation may not be enough; instead, one may need cooperation between monetary and fiscal authorities. This is the lesson I take away from the Rogoff-inspired literature on counterproductive cooperation.[4] It may also be the case in our current situation, where some people talk of a grand bargain to resolve the problem of global imbalances in which the United States offers fiscal consolidation in exchange for monetary adjustment and revaluation in Asia. "International policy coordination" and "central bank cooperation" are not the same things. It is important in debates over policy like the one we are currently having to be clear about which one we are talking about.

[3] Out of politeness to my hosts, it should be noted that this not the only modern view of the role for monetary policy.

[4] See Rogoff (1985). This is also consistent with my view of the 1930s: had there been appropriate fiscal support, central bank cooperation might then have been productive rather than counterproeductive.

References

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