

Willem F Duisenberg: International Research Forum on Monetary Policy, opening address

Opening address by Dr Willem F Duisenberg, President of the European Central Bank, at the International Research Forum on Monetary Policy, Frankfurt, 5 July 2002.

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Ladies and Gentlemen, Dear Governor Gramlich,

It is a pleasure to deliver the opening address of a new transatlantic dialogue – the International Research Forum on Monetary Policy – sponsored by the European Central Bank (ECB), the Board of Governors of the Federal Reserve System, the Center for German and European Studies at Georgetown University (Washington, DC) and the Center for Financial Studies at the Goethe University here in Frankfurt. The European Central Bank is glad to host the first meeting of this research forum.

I am particularly pleased to welcome Governor Gramlich here today, an esteemed colleague and member of the Board of Governors of the Federal Reserve System. He will put his seal, so to speak, on this forum on behalf of our colleagues on the other side of the Atlantic. I should also like to welcome the representatives of the Center for German and European Studies and the Center for Financial Studies, as well as all those who will present or discuss a paper. This forum brings together not only central bankers from both sides of the Atlantic, but also academics. Moreover, I should like to thank the organisers of this first International Research Forum, in particular Ignazio Angeloni, Matt Canzoneri, Dale Henderson and Axel Weber.

Since the establishment of the ECB – four years ago – the dialogue between the ECB and the Federal Reserve System has gradually intensified. It is fair to say (please forgive me, Governor Gramlich) that it took the Federal Reserve System some time to realise that the Eurosystem – the ECB and the national central banks of the countries that have adopted the euro – has become the central banking system of the second largest currency area in the world. Admittedly, it also took the Eurosystem some time to grow into this role, but it has now done so and is seen to have done so, both inside and outside the Eurosystem. Contacts between the ECB and the Federal Reserve System reached their most intense level shortly after the tragic events of 11 September last year. The swap arrangement between the Fed and the Eurosystem, which aimed to prevent a shortage of US dollar liquidity in European markets, was one result. The concerted monetary policy actions on 17 September was another. It is also interesting to note that ties between the Federal Reserve System and the Eurosystem have grown stronger in basically all areas of central banking.

The International Research Forum represents a new link in this network of contacts. It will bring together central bankers and academics from both sides of the Atlantic to discuss new research on the theoretical and empirical aspects of monetary policy that are relevant to the euro area and the United States, but that are also relevant from a global perspective. Moreover, the dialogue will be an ongoing event; we plan to hold meetings like this one on a regular basis. The next one will be in Washington DC, on 14 and 15 November 2003, hosted by the Board of Governors of the Federal Reserve System.

Looking at the programme for today and tomorrow, I can identify three categories of research, and most of the research to be presented here is not limited to just one of these categories.

First, we have issues which are at the heart of monetary policy-making, and which are of great relevance to central bankers worldwide. For instance, work on financial integration and monetary policy, on inflation persistence, and on optimal monetary policy. *Second*, we have research on cross-country comparisons involving the United States and the euro area, and on issues that concern both currency areas, such as regional inflation in a currency union. *Finally*, we have papers on the international dimension of monetary policy-making, including policy co-ordination, the macroeconomics of international price discrimination, the currency denomination of international trade as well as inflation dynamics and international linkages.

Let me touch on one issue which my colleague Otmar Issing will consider in greater depth at dinner tonight. It follows from my introductory remarks about increased co-operation between the Federal Reserve System and the ECB, namely international policy co-ordination. Although I am very much in favour of intensifying the dialogue between the two institutions – I am sure we can learn a lot from

each other – I am, at the same time, one of the first to recognise the limitations of international policy co-ordination. Indeed, we should distinguish between international *co-operation* and international *co-ordination*. In the latter case, policy-makers do not only pursue domestic goals, but also explicitly take into account the impact of their actions on the outside world.

The economic literature – both theoretical and empirical – is clear on this issue. In the stylised and imperfect world of an economic model, policy co-ordination is mostly beneficial, in terms of welfare gains (measured on the basis of a more or less standard utility function). This is the conclusion that emerges from the early literature on policy co-ordination. However, if you try to elaborate this stylised and imperfect world, for instance by introducing transaction costs, uncertainties regarding the true economic model, or game theory considerations, the conclusion is different. Under these circumstances, the gains from international policy co-ordination are non-existent – and a regime of non-co-ordination would in fact be better.

This conclusion from the more recent literature is consistent with the policy line taken by the ECB. Asking monetary policy to do more than maintain price stability, or to serve other purposes, risks creating illusions about what monetary policy can do, as Otmar Issing will explain tonight. In addition, a central bank's ability to steer interest rates can only be used to serve one objective, which is – in most cases – to maintain price stability. This can be achieved either by targeting the exchange rate, a policy typically pursued by small and open economies, or by employing a monetary policy strategy that focuses on the internal stability of the currency, which is the ECB's strategy. Going beyond this is quite a difficult exercise.

Some of the arguments against international policy co-ordination also apply to policy co-ordination *within* the euro area, an issue which will be discussed at the Convention on the Future of Europe. As you might be aware, some commentators and politicians say that policy co-ordination should be stepped up. I agree as far as economic policies are concerned – at least to some extent – but I have serious doubts about any increase in co-ordination between monetary and economic policies. It is obvious that monetary and fiscal policy-makers should *exchange views* on macroeconomic policy in the euro area. This is already done at the meetings of the Eurogroup, and it is highly appreciated also by the ECB. However, an *ex ante* co-ordination of monetary policy and fiscal policy is a completely different story. Policy-makers in these two fields have clear and separate mandates. Monetary policy aims to maintain price stability. Fiscal policy should comply with the Stability and Growth Pact. Mixing up these mandates would unnecessarily complicate policy-making. It would blur competencies – which are well defined in the Treaty on European Union – and might undermine the ECB's credibility as the guardian of price stability. And as the research shows, the gains that can be expected from such *ex ante* co-ordination are non-existent, or even negative. Indeed, I am convinced that the European Central Bank and fiscal policy-makers can best contribute to a stable macroeconomic environment by sticking to their respective mandates.

Ladies and gentlemen, one final word before I hand over to Governor Gramlich: I have not been able to read all your papers, but I am sure that they will provide a more than valuable addition to the body of economic literature and will deepen our understanding of monetary policy-making. I should like to wish you all a very fruitful conference.

Thank you.