



# International Monetary Policy Regimes: Historical Perspectives

Catherine Schenk and Tobias Straumann

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**COMMENT BY**

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## The paper by Schenk-Strauman

It is a story of moving from an international monetary system based on metallic standards-fixed exchange rates to a system based on a fiduciary standard-flexible exchange rates.

In short: from gold to inflation targeting (from fixed to pegged to floating exchange rates) during the past 200 years.

Much cross-country differences/heterogeneity

# The paper by Schenk-Straumann

Three main actors:

1. Central banks
2. Governments (treasuries)
3. Economists

With financial markets on the side (“market forces”)

## The paper by Schenk-Straumann

Schenk-Straumann summarize in a nice way a comprehensive literature – many of its contributors are attending this conference.

The story is straightforward – based on a broad chronology – a historical account with few data and numbers.

How can it be amended?

The paper inspires me to four questions:

1. What is the role of crises in the evolution of the domestic and international monetary system?  
(Policy-learning through crises)
2. Who has the power over monetary policy?
3. Who is the intellectual hero?
4. What is the future of the present system?

# 1. Policy learning and regime transitions through crises

The evolution in the past 200 years of domestic and international monetary policy arrangements can be viewed as the outcome of a *learning process*.

Changes or “reforms” in the *monetary policy regime* – that is in the goals, the instruments and the institutional framework for monetary policy-making – are driven by *major economic crises* hitting the domestic and international economy.

These crisis induce/force policy-makers and economists to rethink the design of monetary policies. They are forced to learn through crises.

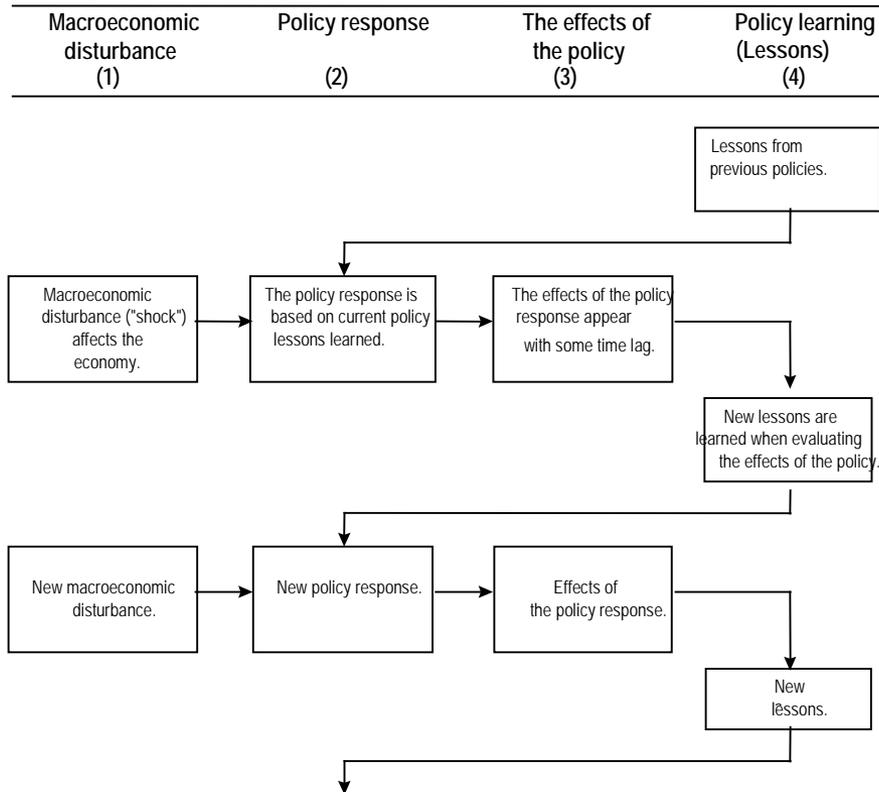
# 1. Policy learning and regime transitions through crises

Policy learning is commonly studied by political scientists and historians:

Lessons from World War I, Pearl Harbour, Munich, Korea, Vietnam etc. A large literature on policy learning.

Economists have displayed little interest in policy learning. Too difficult to “model” in a precise matter – as there is no equilibrium outcome. We cannot use mathematics – only words – boxes and arrows.

**Figure 1. The policy learning process - an outline.**

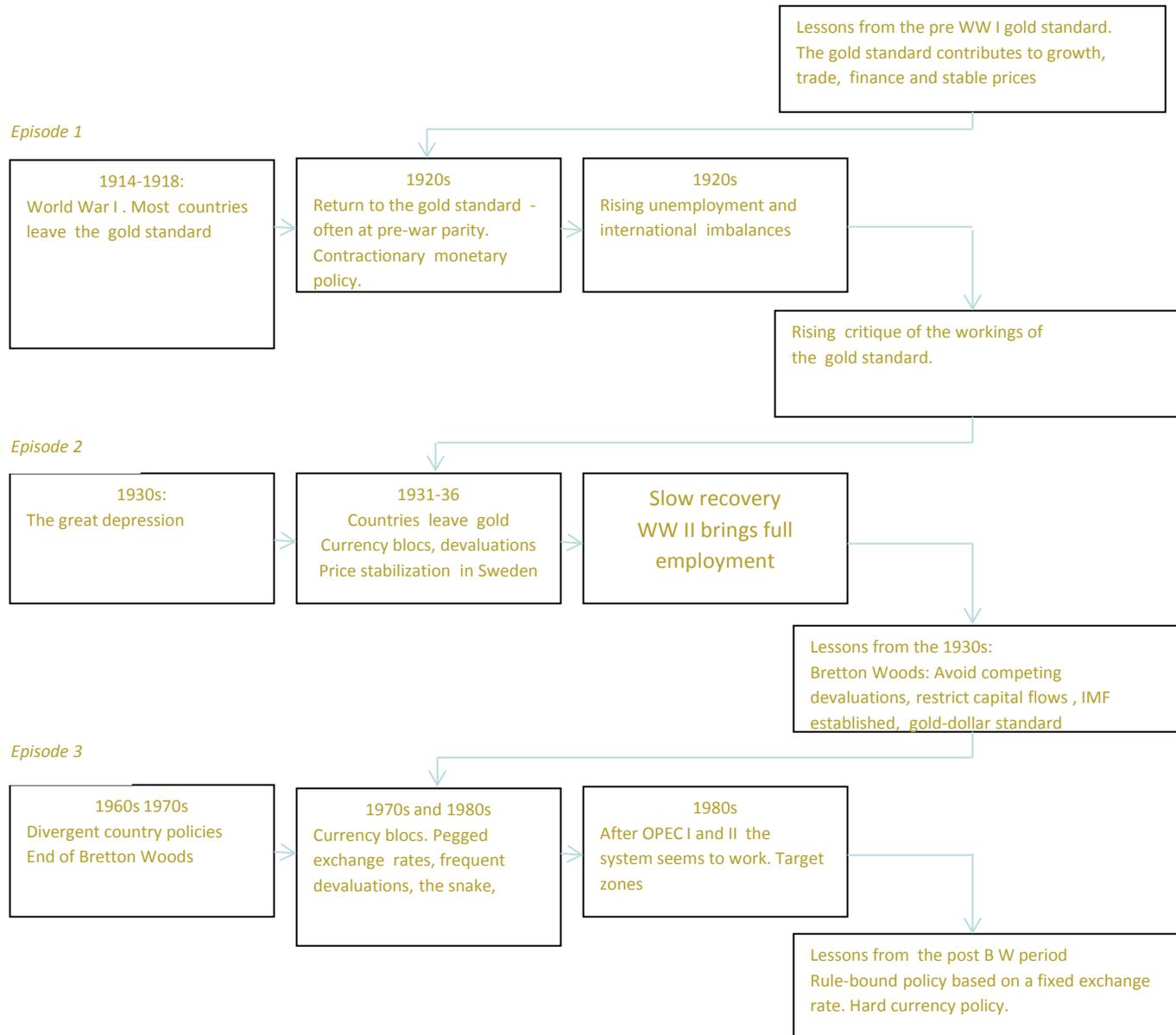


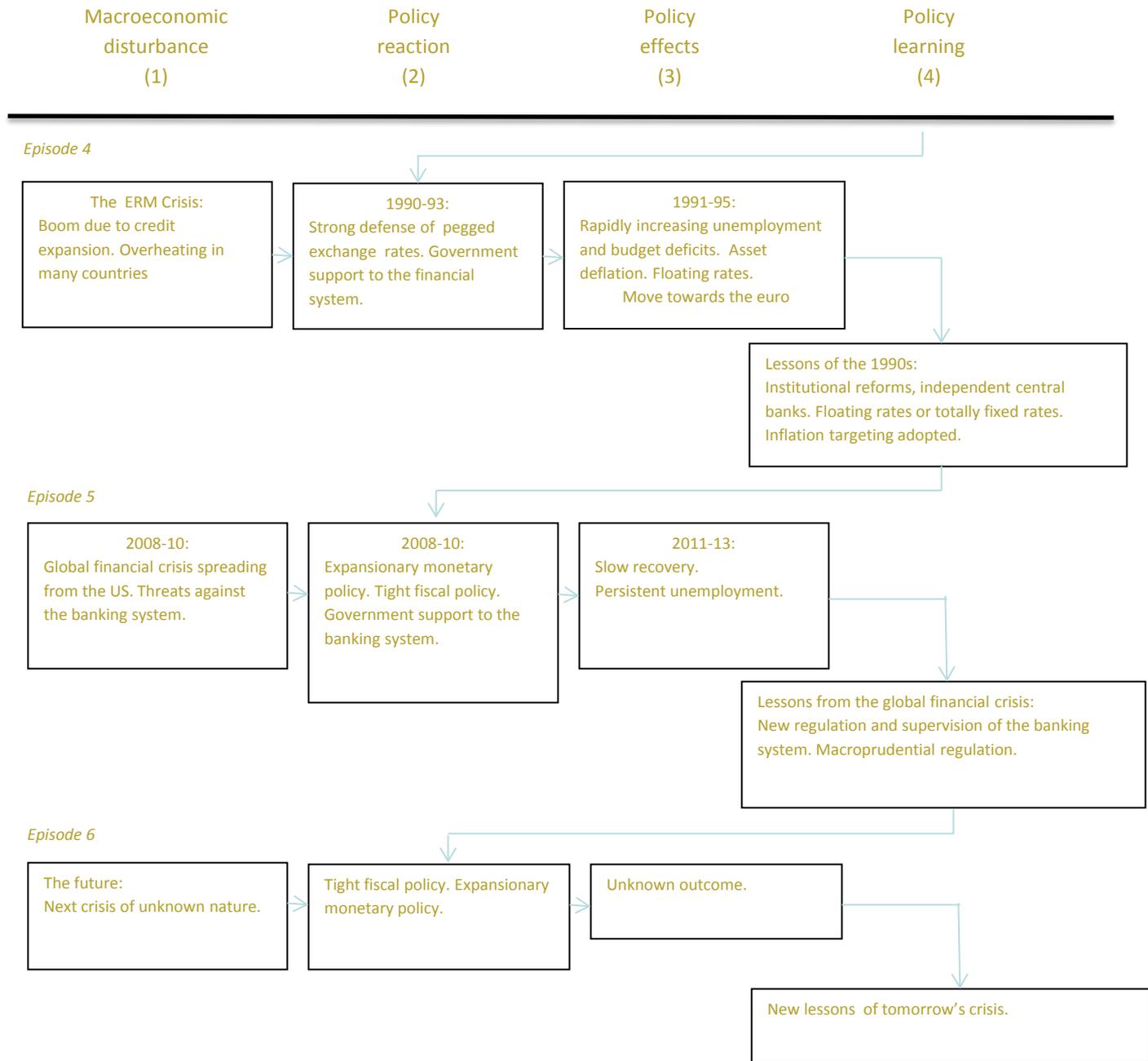
Macroeconomic  
disturbance  
(1)

Policy  
reaction  
(2)

Policy  
effects  
(3)

Policy  
learning  
(4)





# 1. Policy learning and regime transitions through crisis

Crises are driving changes in monetary regimes and monetary policies.

The bigger the crisis, the larger the change in the policy regime.

Q: Who/what is driving the crises?

A: Market forces combined with misguided or badly designed monetary and fiscal policies. There is a role of central banks here. They contribute to the crises that they have to resolve eventually.

# 1. Policy learning and regime transitions through crisis

Q: As noted by Schenk-Straumann: Why are there cross-country differences in exchange rate systems?

A: Differences in the incidence of crises. Countries that not yet have been hit by a sufficiently deep crises still have pegged rates.

Just wait.

# 1. Policy learning and regime transitions through crisis

Most of the conclusions regarding the learning by policy makers also pertain to the learning by the economics profession.

Economists reveal the same tendency as policy makers to condense the lessons from the most recent crisis, deemed relevant, and to limit their retrospective vision.

## 2. Who has the power over monetary policy?

Schenk-Straumann: “important tensions between the central bank’s responsibility for setting and delivering monetary policy while the choice of exchange rate regime is outside its direct control”.

The crises cum policy learning approach gives an answer to this conclusion

## 2. Who has the power over monetary policy?

Power/influence of monetary policy in normal times and in crises:

Actor	Normal times	In crises and in transitions to new regimes
The central bank	Yes	No, little influence
The government/ treasury	Depends on the monetary regime	Yes, decisive influence
The economists	Little influence	Yes, depending on country specifics

## 2. Who has the power over monetary policy?

The people/the voters? Do they have any *direct* power over monetary policy and monetary regimes?

There is only one clear case in monetary history to my knowledge where the public directly has determined the monetary regime:

The Swedish euro-referendum in 2003. The voters had a clear choice between a freely floating exchange rate for the domestic/national currency and a permanently fixed rate to the euro.

They voted according to their perceived costs and benefits of the two monetary regimes. The No side won a clear victory.

3. Who is the intellectual hero?

# KNUT WICKSELL

## (1856-1926)

Professor in Lund 1901-1916

### Interest and Prices

During the classical gold standard, he presented the theory behind the present regime of inflation targeting and suggested his norm of price stability.

It took about 100 years from his policy proposal to policy implementation.

But, his theory has a major missing link contributing to the recent crises.



# 4. What is the future of the present system?

***“No regime has ever been permanent”***, Bordo and Capie, p. 8 in *Monetary Regimes in Transition*, CUP, 1994

Learning is a continuous process, as indicated in the bottom part of the figure of policy learning.

It never ends – unless we have a crisis-free future.

Will that be the case?

Of course, not.

## 4. What is the future of the present system?

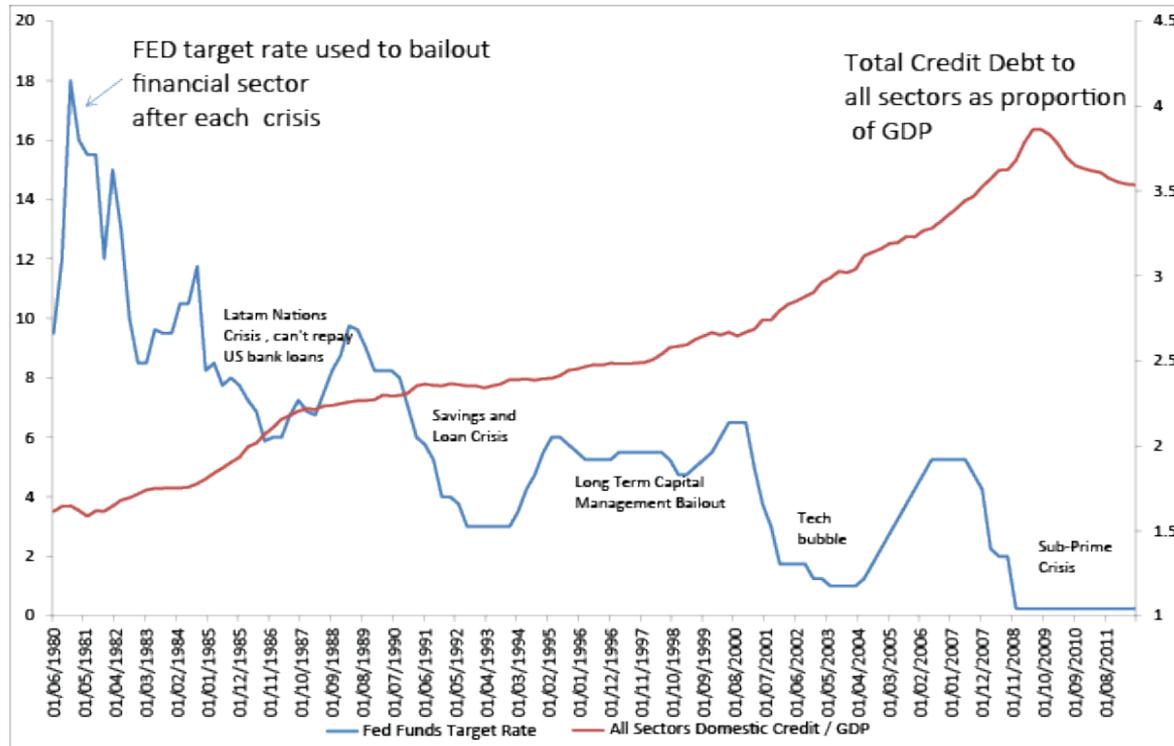
When, where and how is the next big crisis that will change the monetary regime/monetary policy?

One suggestion: the present monetary system has not a well-functioning nominal anchor – like the gold standard world.

Wicksell's theory paved the way for inflation targeting – but also for an unrestricted growth in the volume of credit. His theory does not include asset markets. With a fiduciary standard based on consumer price level stabilization, there is a major risk of financial imbalances due to asset price inflation.

# 4. What is the future of the present system?

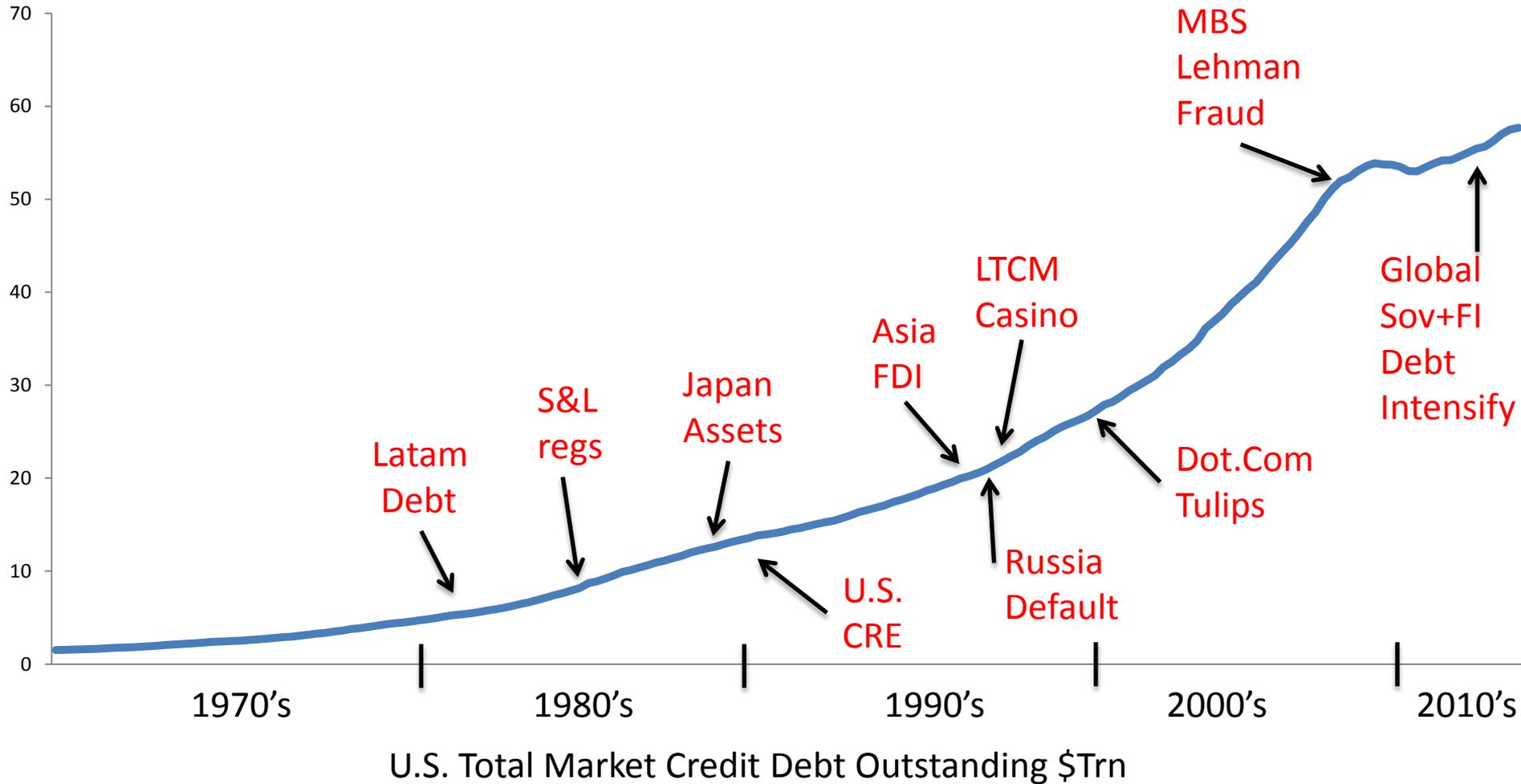
Policies designed to save the financial system has increased the volume of credit over time



# 4. What is the future of the present system?

10 leveraged-induced bubbles in 30 years has not stopped the growth of the debt.

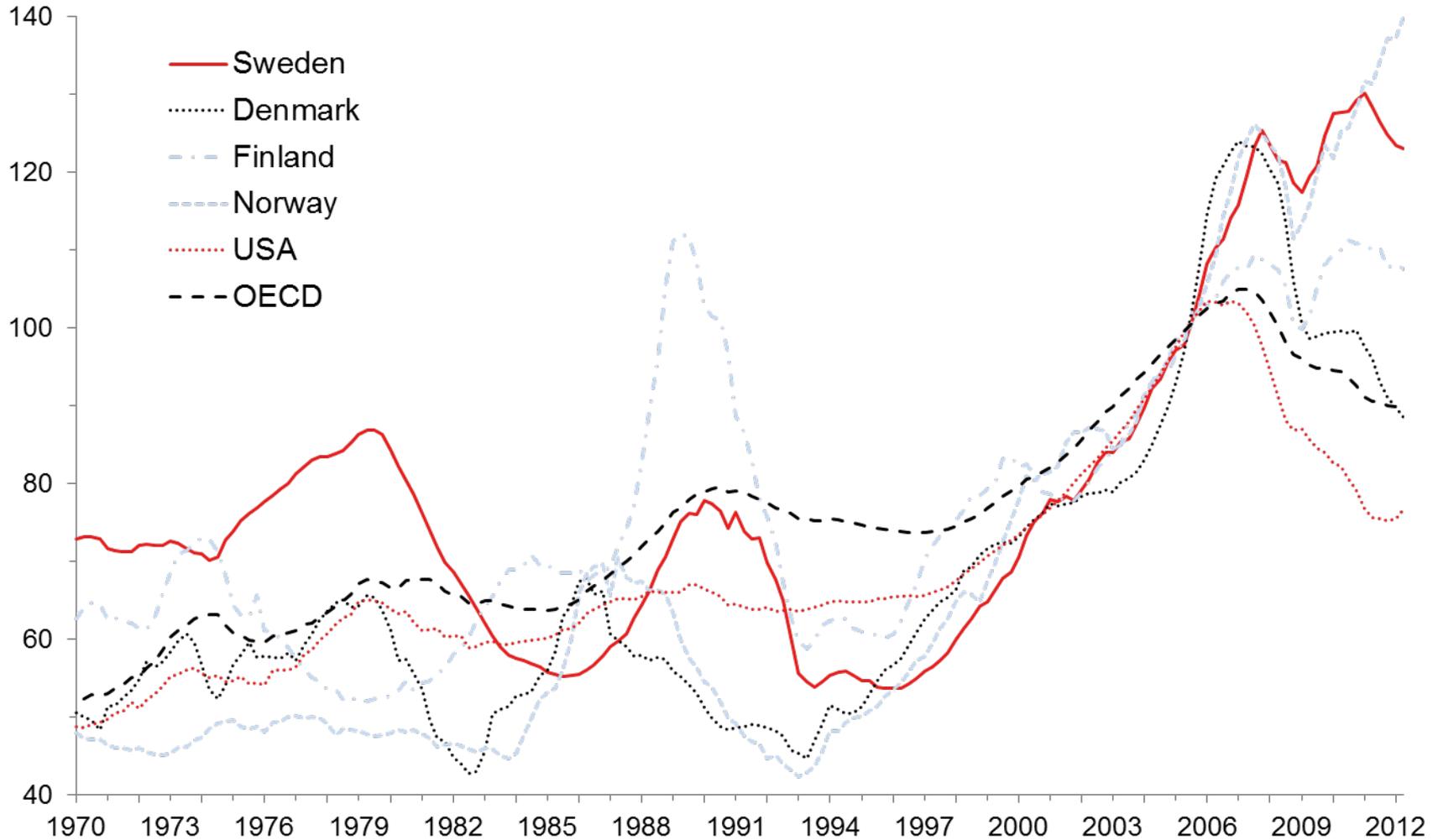
The Fed as a bubble blower



# 4. What is the future of the present system?

## Real house prices

2005=100

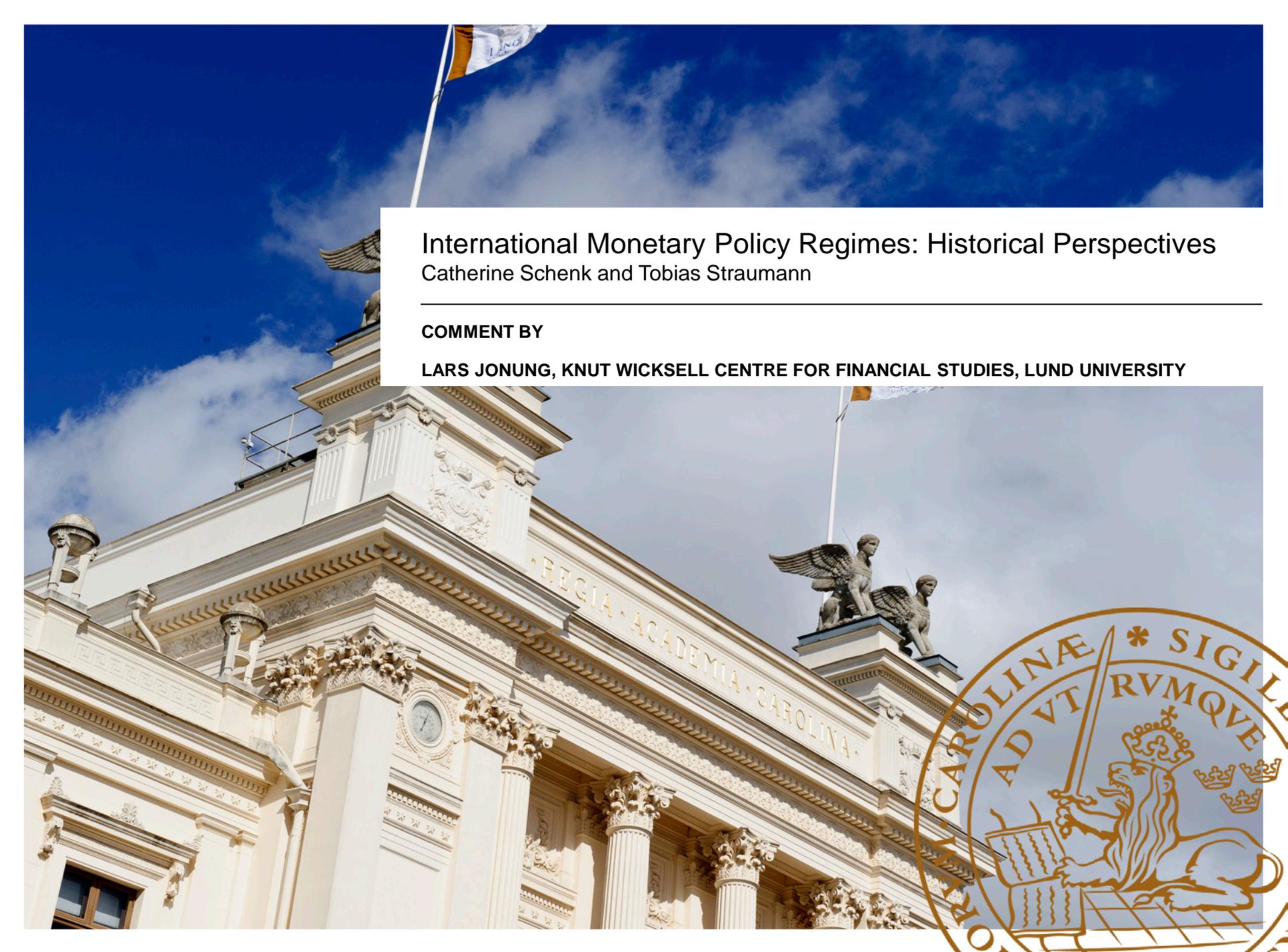


## 4. What is the future of the present system?

Will the policy lessons from our learning of the present crisis be the correct ones?

The future will tell.

Welcome back to another post-crisis conference after the next deep crisis!



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# The learning process

## Stage 1 and 2

The different elements of the learning process are summarised in Figure 1.

Figure is based on separating the course of events into four stages.

The first stage consists of a macroeconomic disturbance – a crisis , see column (1), which –with a time lag - triggers a policy reaction aimed at counteracting the original disturbance – see column (2).

In this second stage, the policy reaction is determined by the lessons obtained from the period/crisis immediately preceding in time.

# The learning process

Stage 3 and 4

Gradually the policy-response affects the macro-economy in stage 3 – see column (3).

Eventually, and in this case the time lag can be considerable, economists and politicians evaluate the effects of the policy measures

In this process they learn the lessons of the crisis, i.e. they revise their opinion concerning the proper policy response.

This learning determines the policy reaction when the next macroeconomic disturbance hits the economy.