Comment

GUILLERMO DE LA DEHESA ROMERO

I agree with most of the points raised by Alexandre Lamfalussy in his very insightful paper, as well as his main argument, i.e. that globalization will further tighten the constraints on national monetary policies, regardless of the anchor mechanism being used by central banks. Nevertheless, for the sake of warming up the debate I am going to make a few points of discrepancy.

First of all let me make few comments on globalization in order to guide my views on this issue.

Financially globalization brings important benefits to the international economy. Saving and investment are allocated more efficiently, enhancing the productivity of capital. Risk is diversified, as investors can spread their portfolios more widely and therefore, and by definition, is reduced. Borrowers get a cheaper financing and investors diversify their risk, both tend to gain.

Nevertheless, financial globalization is still far from complete. There are three basic tests to know if globalization in the capital and money markets is complete or not. The first one is that rich capital countries should tend to have large current account surpluses and scarce capital countries should tend to have large deficits. But, in spite of large reduction in capital restrictions, this has not happened yet. OECD countries have had on average surpluses around 2.5% of GDP. The second is that 'capital mobility' indexes were still higher at the beginning of this century than today. The third one is that real interest rates are not equal among OECD countries. Although covered interest rate parity has fallen significantly, neither investors regard financial assets in OECD countries as perfect substitutes, nor exchange

□ Goldman Sachs Europe, Madrid (Spain) and Centre for Economic Policy Research, London (Great Britain).

BNL Quarterly Review, Special Issue, March 1998.

rates tend to equal expected inflation rates between the OECD economies.

Finally, the effects of globalization on economic policy affect the relative power of fiscal and monetary policy but not so much the absolute effectiveness of both policies. It all depends on the choice of the exchange rate. If the exchange rate is fixed, fiscal policy becomes more effective than monetary policy as an adjustment tool. If, on the contrary, the exchange rate floats, monetary policy is more effective than fiscal policy. The present Asian crisis shows very clearly that fixing the exchange rate is not enough to achieve stability. If the fixing is not accompanied by a fiscal adjustment, given that fiscal policy is more effective (since monetary policy is geared exclusively to maintain the exchange rate fixed), the real exchange rate will appreciate and the current account deficit will, eventually, become unsustainable.

Alexandre Lamfalussy points out four challenges of globalization to monetary policy.

The first one is to money supply targeting, given that globalization affects the controllability of the money supply and the relationship between money supply and prices. I personally think that the undermining of the role of quantitative monetary aggregates as nominal anchors has started already, before globalization, through financial innovation in domestic markets. Lamfalussy gives two reasons why money targeting has advantages over inflation targeting. The first is that it gives a more clear signal to markets about the monetary stance. The second is that it obliges the central banks, in order to be credible, to explain the reason why money supply has diverged from the target. But, in my view, inflation targeting gives also a clear and numerically specified signal to the markets. The transparency and accountability of central banks has greatly increased, not so much with globalization, but with central banks independence, no matter what kind of target is used. As a maker of fact central banks using inflation targeting are at least as transparent if not more as those using money supply targeting.

I agree with Lamfalussy in the sense that the role of the money supply in the inflationary process will continue to be acknowledged maybe more as an indicator than a target, but the difference is not only sematic, there are other indicators being used no matter which targeting is used, and these are not supposed to be targets.

The second challenge of globalization is, according to Lamfalussy, to price stability. He indicates that asset price bubbles tend to increase with globalization and this is even more true when they come from abroad, either through a process of expectation or as a result of growing capital flows. I agree, in principle, but globalization, through higher capital integration and larger competition in goods and services tends to equalize prices of tradable goods and services and rates of return of financial markets that are perceived to be perfect substitutes, but, at the same time, most non tradables as well as real estate and share price bubbles tend to have a larger and more important domestic component. Excessive domestic fiscal and wage policies are the main factors behind asset price bubbles and, therefore, global capital markets should be aware of these domestic distortions before allocating large proportions of their portfolios to countries in such a situation. The present Asian crisis is a clear example of this domestically originated asset bubbles that are enhanced by capital inflows.

The third challenge to monetary policy by globalization is a greater tendency towards real exchange rate misalignments which impose a greater burden of adjustment on monetary policies. According to Lamfalussy, some important features of the ongoing financial globalization is the production of larger and more persistent exchange rate misalignments through massive development of trading activities, growing dependence of banks on services of income other than interest rate spreads and 'short-termism' of financial management. I agree with Lamfalussy in the sense that these factors help to enhance real exchange rate misalignment, but it is very difficult to explain any real exchange rate misalignment if there is not 'real shock' at its origin that produces either diverging trends in long-term productivity or a desincronization of the business cycles. Capital mobility is an enhancing misalignment factor, but the origin is always a real shock, that can be imported as the two oil crises or domestically originated as the German unification shock.

In theory, the more capital markets integrate, the more exchange rates should move to equalize expected inflation differentials among countries and to equalize real interest rates, therefore, globalization should shorten instead of lenghten the misalignments.

The fourth challenge is that globalization tends to increase the systemic fragility of financial markets. Lamfalussy recognizes that, although globalization is a source of instability and it helps the pro-

pagation of local and sectorial crisis, it often contains some shock absorbers. As I said at the beginning, globalization should, in principle, tend to reduce systemic risk, through a larger diversification of risk and a more efficient allocation of savings.

Nevertheless, the reality shows that many financial and monetary institutions are not prepared for globalization. There major threat to systemic fragility is not increased capital mobility but the large heterogeneity of participants in the market. There are many new entrants in the global financial market that are poorly regulated and supervised or not supervised at all. Many central banks and governments are to blame for this situations. Very often regulation and supervision are not enforced by the financial authorities and it enhances systemic risk. This is why central banks should tend to achieve not only monetary but also financial stability, both are today so interlinked that it cannot be achieved one without the other. Again the present Asian crisis is a paradigm of this basic principle. On the other side, the 'herd behaviour' of today's investors is another cause of instability. This problem could be reduced by changing the present system of incentives.

I encourage Alexandre Lamfalussy to develop further his preliminary ideas, given the important monetary and financial issues that are at stake in a globalized world.