Introduction

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The Institute for Monetary and Economic Studies (IMES) of the Bank of Japan (BOJ) held its 12th International Conference on the theme of "Incentive Mechanisms for Economic Policymakers" on May 30 and 31, 2005. (See Appendix 1 for a list of the round-table participants.)

The conference focused on how to design incentive mechanisms for economic policymakers. Specifically, it considered mechanisms to deal with the incentive problems in five areas of research: a monetary policy committee in a central bank, prudential policy, domestic financial markets, international financial markets, and fiscal policy.

The conference began with an opening speech by BOJ Governor Toshihiko Fukui, followed by keynote speeches from the two honorary advisers of IMES, Bennett T. McCallum and Maurice Obstfeld. The five subsequent sessions consisted of presentations and discussions of papers on how to design incentive mechanisms for economic policymakers. The conference ended with a panel discussion session on macroeconomic policy and central banking. (See Appendix 2 for the program.)

Session 1, entitled "The Monetary Policy Committee and the Incentive Problem: A Selective Survey," focused on the incentive problems related to having a monetary policy committee in an independent central bank and the disclosure of information from the monetary policy committee.

Session 2, entitled "Prudential Policy," examined a regulatory and supervisory system to deal not only with individual bank failures (micro-prudential regulation) but also with systemic crises (macro-prudential regulation), taking into account the incentive problems faced by the regulators.

Session 3, entitled "Marking to Market, Liquidity, and Financial Stability," examined the externalities arising from mark-to-market accounting and their procyclical effects on asset prices. Balance-sheet regulations applying to institutional investors provided incentives for these investors to purchase more of an asset if its price was rising under mark-to-market accounting.

Session 4, entitled "International Financial Integration, Sovereignty, and Constraints on Macroeconomic Policies," considered the incentive effect of sovereignty on international financial flows and the debt limits of nations.

Session 5, entitled "Searching for Non-Monotonic Effects of Fiscal Policy: New Evidence," empirically analyzed whether the response of national savings to fiscal policy appeared to be non-monotonic.

The concluding panel discussion session, entitled "Macroeconomic Policy and Central Banking," focused on three topics: transparency in monetary policy, continuity of monetary policy, and coordination between monetary policy and other macroeconomic policies. Three panelists, representing the European Central Bank, the Federal Reserve Bank of San Francisco, and the BOJ, expressed their views on these topics. The two honorary advisers of IMES served as designated discussants.

First, we summarize the main points of the conference discussions on monetary policy in Session 1 and the concluding panel discussion session below.

(1) The participants at the conference agreed that an independent central bank should have an overarching legislative guidance to pursue price stability. However, the participants' opinions differed about the types of independence a central bank should have, such as instrument independence versus goal independence. Some participants wondered whether tension would arise between a central bank's price stability objective and other objectives.

(2) The participants agreed that no single practical answer to the question on the optimal size of a monetary policy committee existed. Participants' opinions differed on issues related to membership of the committee: the appropriate background of committee members (for example, whether the members should be central bank insiders, or outsiders, such as academics) and whether committee members should represent some regions in a currency union.

(3) Some participants expressed negative theoretical views on the maintenance of monetary policy continuity when committee members have finite terms of office. However, other participants argued that it would be possible to maintain the continuity of monetary policy in practice for four reasons. First, the government could establish an overarching legislative guidance to pursue price stability. Second, the new members' views on monetary policy (for example, the desired rate of inflation) might be close to that of incumbent members. Third, only a portion of the committee was replaced at any one time. Finally, central bank staff might provide some continuity in decision making by supplying consistent economic forecasts.

(4) The participants agreed that the disclosure of information on monetary policy committee decisions increased the committee's accountability to the public, and increased the public's sense of ownership of the committee. However, some participants argued that the disclosure of information on the future course of monetary policy could actually influence expectations and that the effectiveness of such policy should not be overemphasized. They argued that providing information on the future course of monetary policy based only on the rate of inflation might affect the signaling role of market prices by distorting the market prices of some assets, such as long-term government bonds.

Second, we summarize the main points of the conference discussions on the other economic policies from Sessions 2 to 5 below.

(5) A new theoretical framework to deal not only with individual bank failures (micro-prudential regulation) but also with systemic crises (macro-prudential regulation) was proposed. The proposal consisted of four main points. First, liquidity assistance by a central bank should be restricted to banks with low exposure to macro shocks. Second, supervisors should select these banks, which then would face a capital requirement and a deposit insurance premium, both of which would increase with their macro exposure. Third, banks with an excessively high macro exposure would face a flat-rate capital

requirement and should not receive liquidity assistance in the case of macro shocks. Finally, central bank loans should be insured by a deposit insurance fund. Participants pointed out that the proposal provided a new theoretical building block to analyze systemic crises. However, some participants wondered if the assumptions of the model could be justified empirically. For example, some participants wondered if macro exposure for an individual bank was observable to supervisors on a real-time basis.

(6) Regarding the financial stability implications of mark-to-market accounting, if market prices not only served as a signal of the underlying fundamentals but also influenced the actions of market participants, the loop between actions and market price could generate amplified responses—that is, the creation of bubble-like booms in asset prices and the magnification of distress episodes in downturns. Most participants agreed on the theoretical destabilizing effects of mark-to-market accounting. However, many participants argued that the decision to choose mark-to-market accounting should weigh various benefits and costs that were not included in the model.

(7) A model of sovereignty constraint in a global financial market was presented. If creditors could not observe shocks to domestic fundamentals, government borrowing (foreign and domestic) faced a debt limit. The debt limit arose because a sovereign government chose whether to honor its own obligations or to default on its current debt and never issue debt again. The ability of a sovereign to borrow depended upon its willingness to repay. The debt limit constrained the exercise of fiscal policy. In addition, it could constrain monetary policy if some debt were denominated in the local currency. Creditors could not tell whether expansionary monetary policy was justified, and an inflation surprise would be viewed as a default. The participants discussed whether the feature of procyclical fiscal policy in the model was consistent with empirical observations. They also discussed whether the model could be applicable to non-emerging market countries or emerging market countries.

(8) Using data on 19 OECD countries, empirical results showed that the response of national savings to fiscal policy appeared to be non-monotonic. The non-monotonic response of national saving was seen under a “large and persistent” fiscal impulse, defined as one in which the full employment surplus, as a percentage of potential output, changes by at least 1.5 percentage points per year over a two-year period. Participants discussed the robustness of the results and concluded that it was premature to use these results for policy recommendations.

APPENDIX 1: LIST OF ROUND-TABLE PARTICIPANTS

Naohiko Baba
Bank of Japan

Erdem Başçi
Central Bank of the Republic of Turkey

Alex Bowen
Bank of England

David H. Bowman
Board of Governors of the Federal Reserve System

Jean-Philippe Cotis
Organisation for Economic Co-operation and Development

Charles L. Evans
Federal Reserve Bank of Chicago

Wolfgang W. Fritsch
Deutsche Bundesbank

Hiroshi Fujiki
Bank of Japan

Toshihiko Fukui
Bank of Japan

Francesco Giavazzi
Università Bocconi

Reuven Glick
Federal Reserve Bank of San Francisco

Christopher B. Gomez
Bangko Sentral ng Pilipinas

Marvin Goodfriend
Federal Reserve Bank of Richmond

James Harrigan
Federal Reserve Bank of New York

Hideo Hayakawa
Bank of Japan

Eiji Hirano
Bank of Japan

Nobuo Inaba
Bank of Japan

Kazumasa Iwata
Bank of Japan

Jiao Jinpu
The People's Bank of China

Keimei Kaizuka
Chuo University

Jonathan Kearns
Reserve Bank of Australia

Myung Kee Kim
The Bank of Korea

Kenneth Kletzer
University of California at Santa Cruz

Ulrich Kohli
Swiss National Bank

Yasuhiro Maehara
Hitotsubashi University

José Luis Malo de Molina
Banco de España

Bennett T. McCallum
Carnegie Mellon University

Atsushi Mizuno
Bank of Japan

Toshiro Muto
Bank of Japan

Hiroshi Nakaso
Bank of Japan

Kiyohiko G. Nishimura
Bank of Japan

Maurice Obstfeld
University of California at Berkeley

Kunio Okina
Bank of Japan

Wensheng Peng
Hong Kong Monetary Authority

George Pickering
Bank of Canada

Robert H. Rasche
Federal Reserve Bank of St. Louis

Eli M. Remolona
Bank for International Settlements

John C. Robertson
Federal Reserve Bank of Atlanta

Jean-Charles Rochet
University of Toulouse

Hartadi A. Sarwono
Bank Indonesia

Wolfgang Schill
European Central Bank

Hyun Song Shin
London School of Economics

Masaaki Shirakawa
Bank of Japan

Shigenori Shiratsuka
Bank of Japan

Miyako Suda
Bank of Japan

Kenichiro Watanabe
Bank of Japan

Hirohide Yamaguchi
Bank of Japan

Janet L. Yellen
Federal Reserve Bank of San Francisco

Jeromin Zettelmeyer
International Monetary Fund

APPENDIX 2: PROGRAM

Monday, May 30, 2005		
9:00	**Opening Session**	
	Chairperson:	**Kazumasa Iwata**, Bank of Japan
	Opening Speech:	**Toshihiko Fukui**, Bank of Japan
	Keynote Speeches:	**Bennett T. McCallum**, Carnegie Mellon University
		Maurice Obstfeld, University of California at Berkeley
10:30	**Session 1 on "The Monetary Policy Committee and the Incentive Problem: A Selective Survey"**	
	Chairperson:	**Charles L. Evans**, Federal Reserve Bank of Chicago
	Paper Presenter:	**Hiroshi Fujiki**, Bank of Japan
	Discussants:	**Marvin Goodfriend**, Federal Reserve Bank of Richmond
		Ulrich Kohli, Swiss National Bank
13:30	**Session 2 on "Prudential Policy"**	
	Chairperson:	**Nobuo Inaba**, Bank of Japan
	Paper Presenter:	**Jean-Charles Rochet**, University of Toulouse
	Discussants:	**Alex Bowen**, Bank of England
		Wensheng Peng, Hong Kong Monetary Authority
15:30	**Session 3 on "Marking to Market, Liquidity, and Financial Stability"**	
	Chairperson:	**Atsushi Mizuno**, Bank of Japan
	Paper Presenter:	**Hyun Song Shin**, London School of Economics
	Discussants:	**Eli M. Remolona**, Bank for International Settlements
		George Pickering, Bank of Canada
17:10	**Adjournment**	

Tuesday, May 31, 2005		
9:00	**Session 4 on "International Financial Integration, Sovereignty, and Constraints on Macroeconomic Policies"**	
	Chairperson:	**Eiji Hirano**, Bank of Japan
	Paper Presenter:	**Kenneth Kletzer**, University of California at Santa Cruz
	Discussants:	**Jeromin Zettelmeyer**, International Monetary Fund
		Jonathan Kearns, Reserve Bank of Australia

10:55 Session 5 on "Searching for Non-Monotonic Effects of Fiscal Policy: New Evidence"

Chairperson:	**Jean-Philippe Cotis**, Organisation for Economic Co-operation and Development
Paper Presenter:	**Francesco Giavazzi**, Università Bocconi
Discussants:	**Reuven Glick**, Federal Reserve Bank of San Francisco
	Robert H. Rasche, Federal Reserve Bank of St. Louis

14:00 Concluding Panel on "Macroeconomic Policy and Central Banking"

Chairperson:	**Yasuhiro Maehara**, Hitotsubashi University
Panelists:	**Wolfgang Schill**, European Central Bank
	Janet L. Yellen, Federal Reserve Bank of San Francisco
	Masaaki Shirakawa, Bank of Japan
Discussants:	**Bennett T. McCallum**, Carnegie Mellon University
	Maurice Obstfeld, University of California at Berkeley

17:00 Adjournment