Rules of the Monetary Game

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Aggressive monetary policy actions by one country can lead to significant adverse cross-border spill overs on others, especially as countries contend with the zero lower bound. If countries do not internalize these spill overs, they may undertake policies that are collectively suboptimal. Perhaps instead, countries could agree to guidelines for responsible behaviour that would improve collective outcomes. This paper puts forward some of the practical issues that need to be considered in framing possible rules of the monetary game. It is argued that policies could be broadly characterized and rated based on analytical inputs and discussion. Policies that generally have positive or domestic effects could be rated Green, policies that should be used temporarily and with care could be rated Orange, and policies that should be avoided at all times could be rated Red. The study provides a brief review of the some of the frameworks that have been used in the literature to measure and analyze spill overs. The study make the case that models may reflect the policy biases of those devising them, and may be at too early a stage to be able to draw strong conclusions from them. Therefore, while more empirical analysis should be undertaken, it should be seen as an input to a dialogue rather than definitive, with the analysis being refined as to understand outcomes better. The paper also discusses the specific role of the IMF in this context.

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