

# Comments on Corsetti et al.

Charles Wyplosz

The Graduate Institute, Geneva

## Two innovative contributions

- MP and FP should be strategic complements
  - In a tail risk situation where both policy
- Exit tail risk by going to the middle of t
- Old principles but re-engineered to curi
- New view on policy coordination raises
  - Why are we stuck in tail risk situation?
  - Can we expect FP to do it right?
  - Should MP continue to carry the world?



# Why are we stuck in tail risk situation?

- Shocks, not all exogenous
- Low  $R^*$ 
  - Structural causes (saving glut, demography, productivity, inequality, etc.)
  - Interest rates low for far too long + yield curve control when demand expectations are depressed
    - Another multiple equilibrium story
- Very active MP substituting for inactive FP
  - Before getting into tail risk situation
  - Lack of complementarity outside tail risk situation

# Can we expect fiscal policy to do it right?

- Poor track record
- Last crisis: 2007-8
  - Good for a couple years, then premature withdrawal
- A key reason : fear of indebtedness
  - Poorly understood
  - Political but also 'alchemy' and reliance on poorly designed rules
- Need for science-based fiscal rules
  - A shining example: New Zealand (not just Covid)
  - Urgent in the Euro Area to avoid premature withdrawal

# Should MP continue to carry the world?

- Central banks saved the world until they became stuck
  - They invented more instruments that are not effective enough to do the job
    - Low for long interest rates at their lower bounds
    - Balance sheet expansions
    - Macro-pru is not monetary policy
  - They encouraged inactive fiscal policies
    - Even when  $r < g$
- Can they stop?
  - Can mandates be reinterpreted?
  - Is monetary dominance a threat to independence?

# The particular case of the Euro Area

- Coordination ECB-19 governments
  - No mechanism
    - New: A sort of coordination among governments
  - Differing national conditions and fiscal policy sovereignty
  - ECB independent but under influence
- Two suggestions
  - Ditch Stability and Growth Pact and replace with a good science-based rule before end of 2021
  - ECB to stop trying to 'save the world'
    - Complementarity, yes: Backstop to debts (aka balance sheet policy)
    - Substitutability, no: exit negative rate (cf Sweden)

**Thank you.**