International Political Economy (SOCS-SHU 222)

A STATE-CENTERED APPROACH TO MONETRY AND EXCHANGE-RATE POLICIES

Instructor: JING QIAN

Guest Lecture

- This Thursday, Apr 17
- **Room Change: N201**
- Reading posted on syllabus

NYU SHANGHAI 上海纽约大学

SOCS-SHU 222: International Political Economy
Guest Lecture Series

Institutional Design and Mandate Expansion:

Explaining the governance responses of international organizations to climate change

Date: Thursday, Apr 17, 2025
Time: 9:45 - 11:00 AM
Location: N201
Speaker: Dr. Yi-Jiang Zhou
Assistant Professor, School of Politics and International Relations, Tongji University

Climate governance increasingly engages international organizations operating beyond their original mandates. These organizations exhibit significant variations in their climate engagement levels and effectiveness, reflecting different institutional responses to varying climate-related pressures.

Through comparative analysis of the World Bank, WHO, and UN Security Council, the research finds that organizations with higher pooling and delegation levels more effectively overcome resistance to mandate expansion. NATO, however, presents a critical exception, highlighting that beyond institutional design, the specific drivers behind functional expansion also significantly influence an organization's progress and effectiveness in new issue areas.

Hosted by Jing Qian, Assistant Professor Faculty Fellow of Political Science, NYU Shanghai

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https://www.youtube.com/watch?v=SfNC_-Qc1sI

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← **Truth Details**

259 replies

Donald J. Trump

@realDonaldTrump

The Fed would be MUCH better off CUTTING RATES as U.S.Tariffs start to transition (ease!) their way into the economy. Do the right thing. April 2nd is Liberation Day in America!!!

642 ReTruths **2.33k** Likes Mar 20, 2025, 10:10 AM

A State-Centered Approach to Monetary and Exchange-Rate Policies

READING ASSIGNMENT:

Oatley Chapter 13

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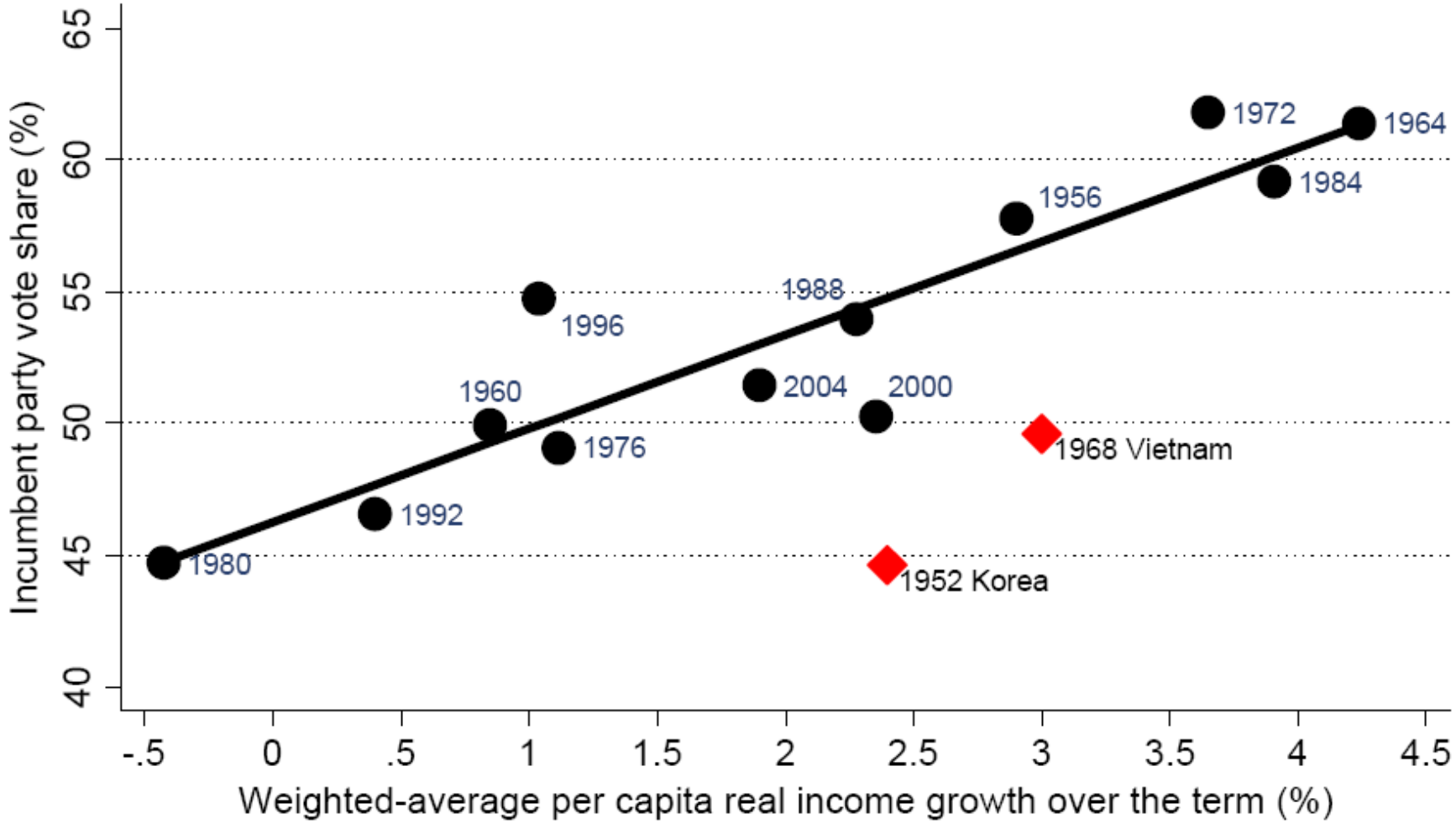
Show Me the Money!

Figure 1. Bread and Peace Voting in US Presidential Elections



Government Incentives to Promote Economic Growth

- Might lead to perverse policies
- Loose monetary policy (low interest rates)
- Can lead to INFLATION

Show Me the Money!

- It's all about commitment
- **Insulate** policy-makers from short-term political pressures
- What's the time-consistency problem?
- *Time 1:* beginning of your term in office
- *Time 2:* right before elections
- *Option A:* sound monetary policy
- *Option B:* drop interest rates
- *Time 1:* U(A2)>U(B2)
- *Time 2:* U(A2)<U(B2)
- *The "sirens":* electoral pressures
- *The commitment?*
  - Fixed Exchange Rates
  - Independent central banks

Let’s Break It Down

First: Sirens
Second: Commitment

First – the "sirens" policy mechanism: Monetary Policy & Unemployment

- Assume there's a "natural rate of unemployment"
  - New entrants, labor unions, minimum wages, hiring & firing practices, unemployment compensation… (raise the wage, lower the demand for labor)
- Workers care about their REAL wage (purchasing power), but paid a NOMINAL wage
- An unanticipated reduction of the interest rate ➔ unexpected increase in inflation ➔ lower REAL wage ➔ ***reduce unemployment*** ☺
- (An unanticipated increase of the interest rate ➔ unexpected decrease in inflation ➔ increase REAL wage ➔ ***increase unemployment*** ☹)
- In the long-run, labor market adjusts and changes are reversed ➔ return to the "natural rate of unemployment"

But is there a cost?

- If a government continually uses monetary policy to keep unemployment below the natural rate, it must continually increase the rate of inflation (“accelerationist principle”)

- The Phillips curve illustrates this

Phillips Curve

Inflation-Unemployment Trade-Off

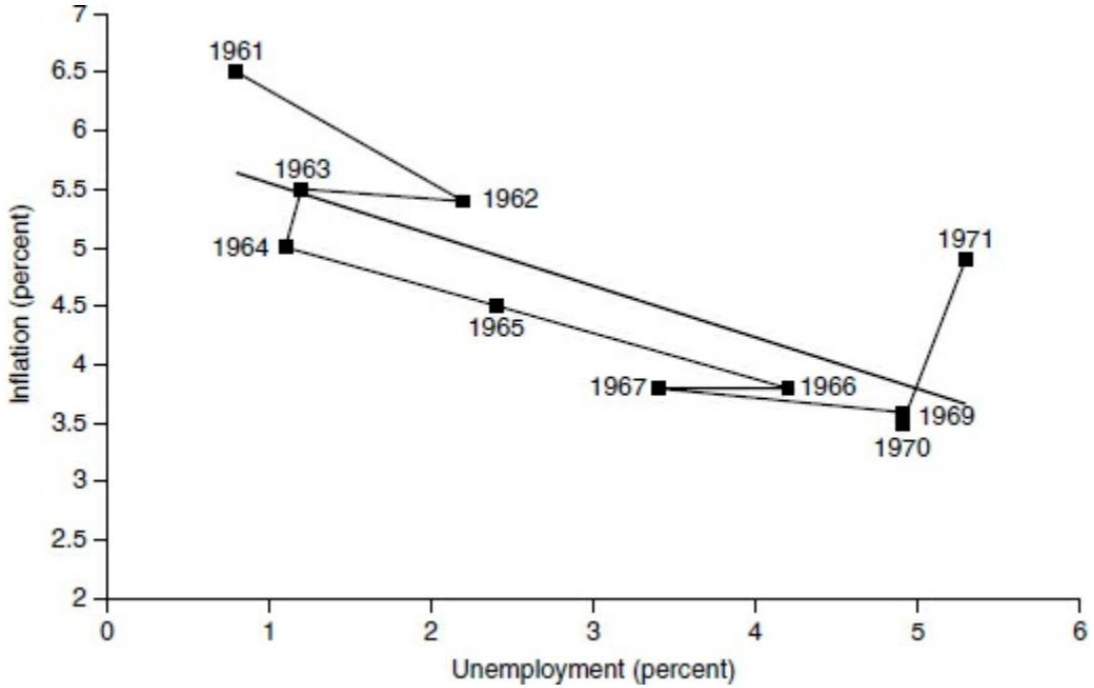


FIGURE 12.1

The Phillips Curve in the United States, 1961–1971

Source: United States Government, *Economic Report of the President* (Washington, DC: Government Printing Office, 2002).

Phillips Curve

Inflation-Unemployment Trade-Off???

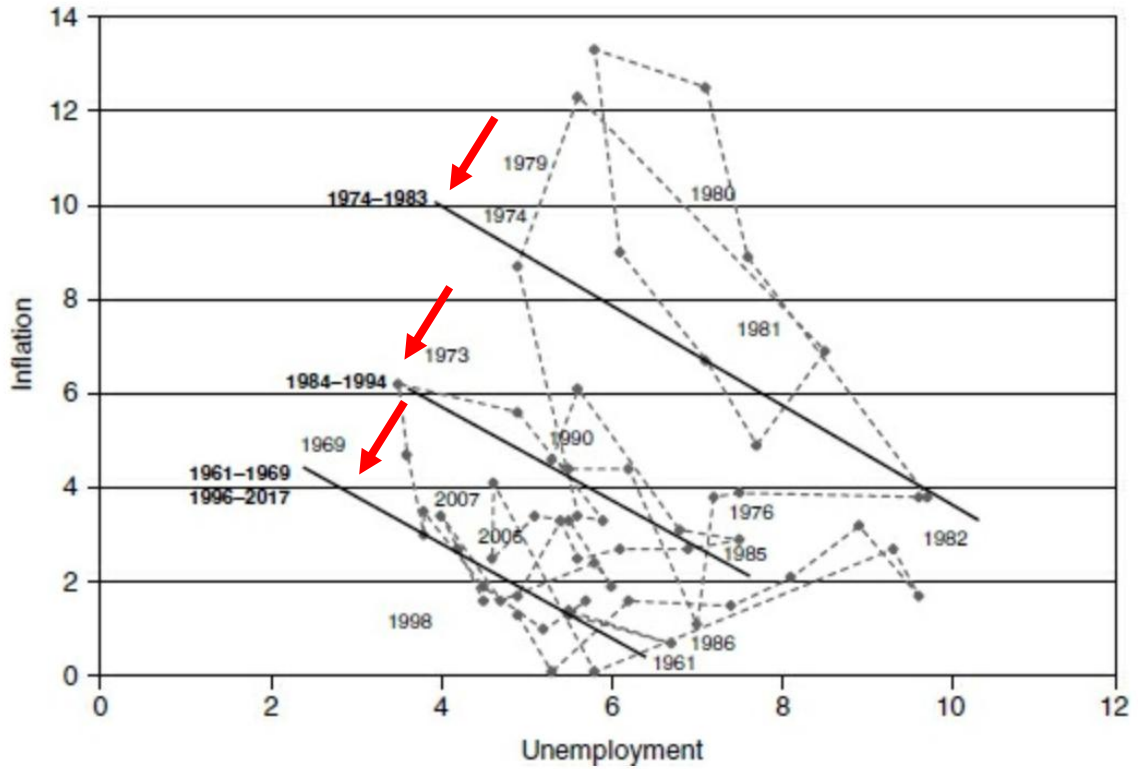


FIGURE 13.2

Phillips Curves in the United States, 1961–2017

Source: FRED: Economic Data, Federal Reserve Bank of St. Louis.

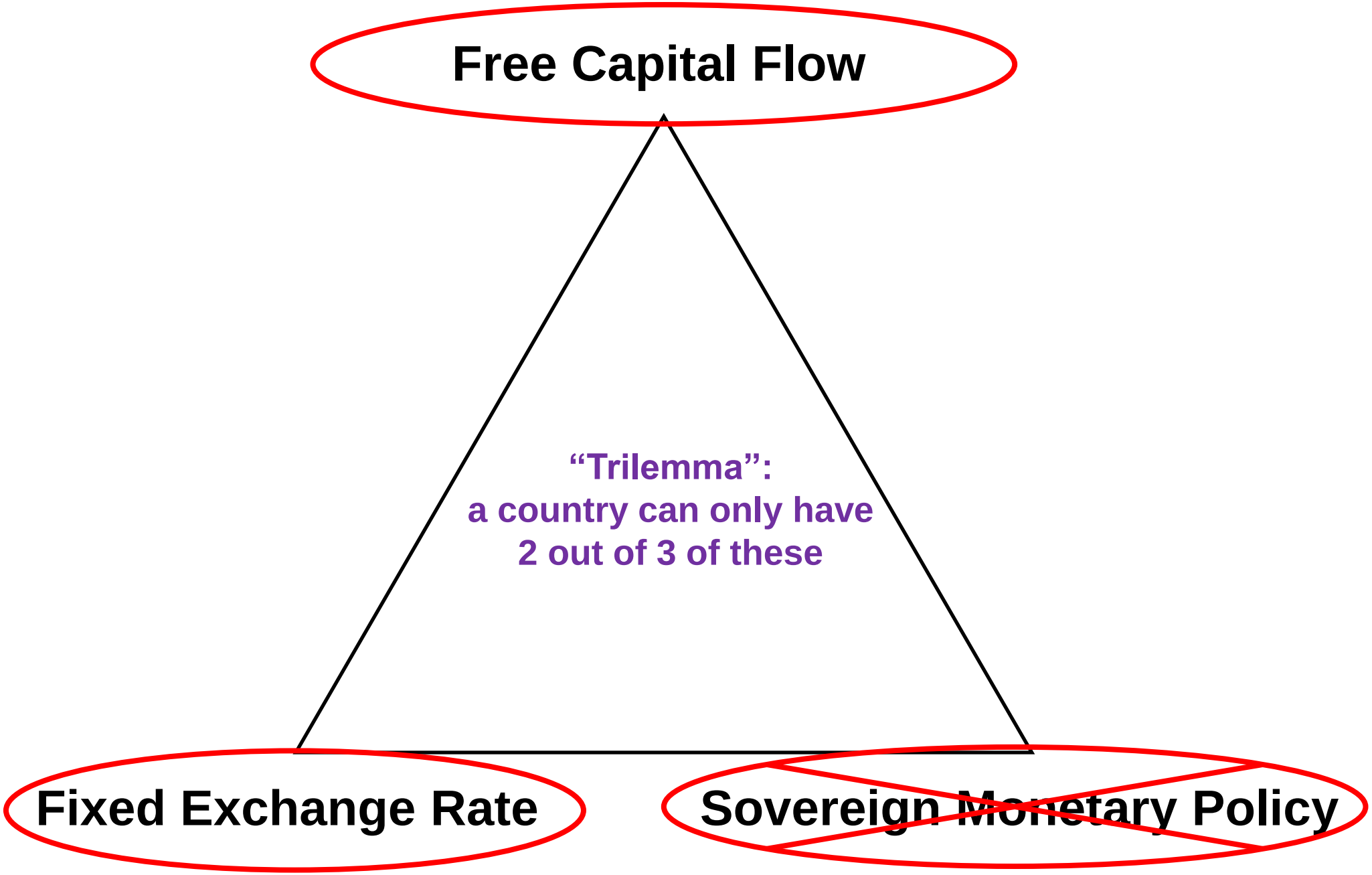
http://www.andrew.cmu.edu/course/88-301/phillips/phillips_curve.gif
Courtesy of Peter Thompson Intermediate Macroeconomics, Carnegie Mellon. Also see Oatley, p375, fig 13.2

1. Over the past 40 years, the Phillips curve has shifted first out then in again, as changes in the natural rate of unemployment and in expected inflation have altered the terms of the short-run trade-off between inflation & unemployment
2. In the early 1960s, the Phillips curve trade-off was favorable: low unemployment with low inflation
3. The "new economics" of the 1960s led to an attempt to move to the upper right end of the Phillips curve, in the hope of exploiting a presumed permanent – not just a short-run – trade-off between inflation & unemployment
4. By 1971, the short-run Phillips curve had ***shifted out!*** Too many years of creeping inflation had destroyed the Federal Reserve's credibility as an inflation fighter, and had ***raised expected inflation***
5. The 1973 tripling of of world oil prices caused a further outward shift in the Phillips curve
6. By 1975, the short-term inflation-unemployment trade-off had become unfavorable – to keep unemployment down at 5% would require 12% inflation, to reduce inflation to 3% would require 10% unemployment
7. In the early 1980s, Federal Reserve Chair Paul Volker decided to attempt to reestablish the Federal Reserve's inflation-fighting credibility by doing whatever was necessary to reduce inflation
8. By 1985, it was clear that Volcker disinflation had "succeeded." At the price of a few years of high unemployment, Federal Reserve's inflation-fighting credibility had been restored and the short-run Phillips curve had ***shifted inward***
9. But even so, the Phillips curve of the late 1980s & early 1990s was not as favorable as that of the 1960s
10. The mid-1990s, however, saw a further ***inward shift*** of the Phillips curve: an apparent fall in the natural rate of unemployment (welfare reform?)

What is the real cost?

- Pp.376 Oatley:
  - Inflation raises uncertainty among firms & unions
  - **This uncertainty can *reduce* investment & *economic growth***
  - This, in turn, ***raises*** the natural rate of ***unemployment***

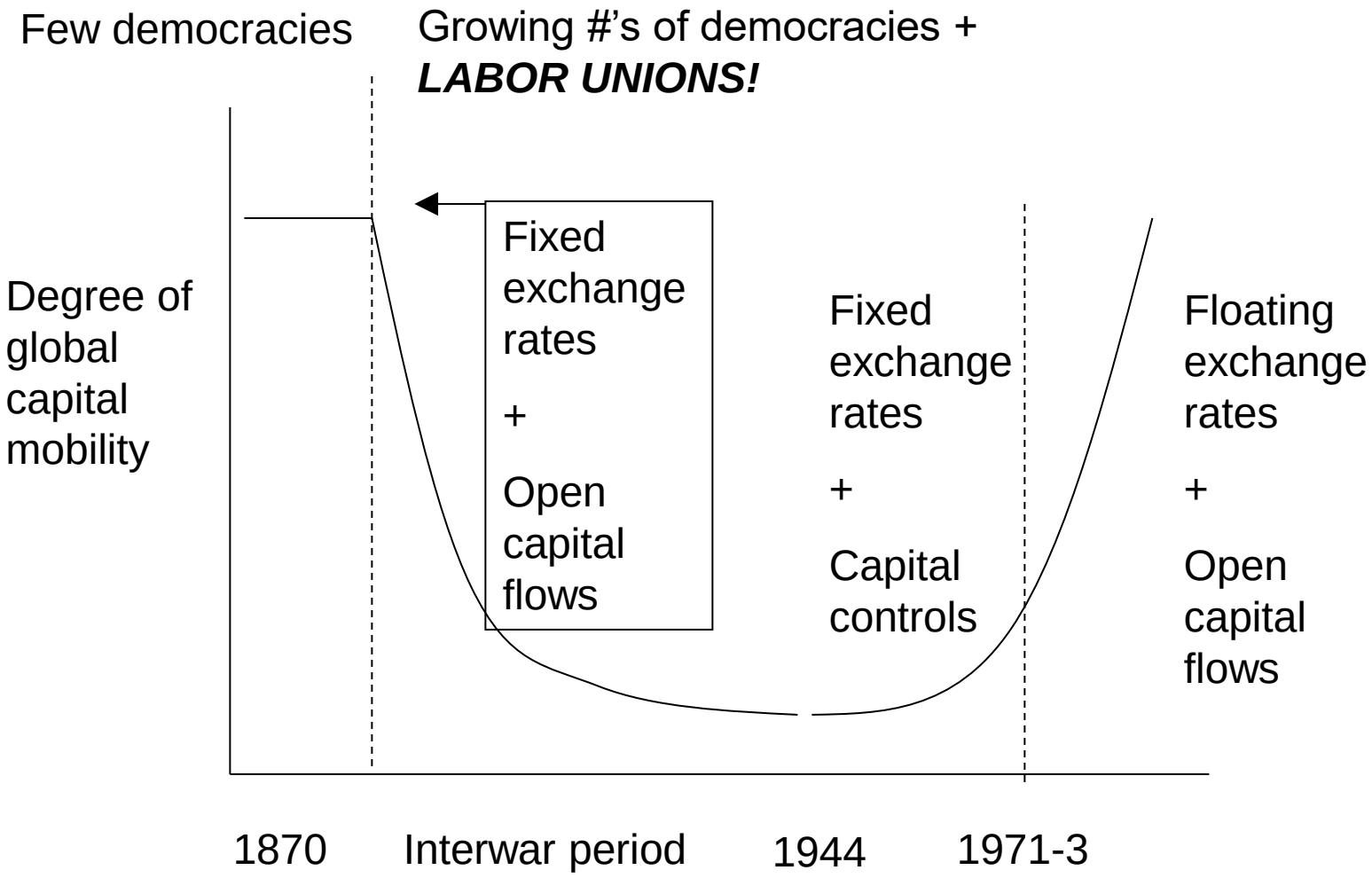
How do we address the threat of inflation?


Free Capital Flow
“Trilemma”:
a country can only have
2 out of 3 of these
Fixed Exchange Rate
Sovereign Monetary Policy

Fixed Exchange Rate as a commitment

- The answer to the trilemma is precisely to sacrifice monetary autonomy!
- But is this a wise approach?
- Recall the old mix of fixed XR & open capital flows with DEMOCRACY

Answer: Democracy

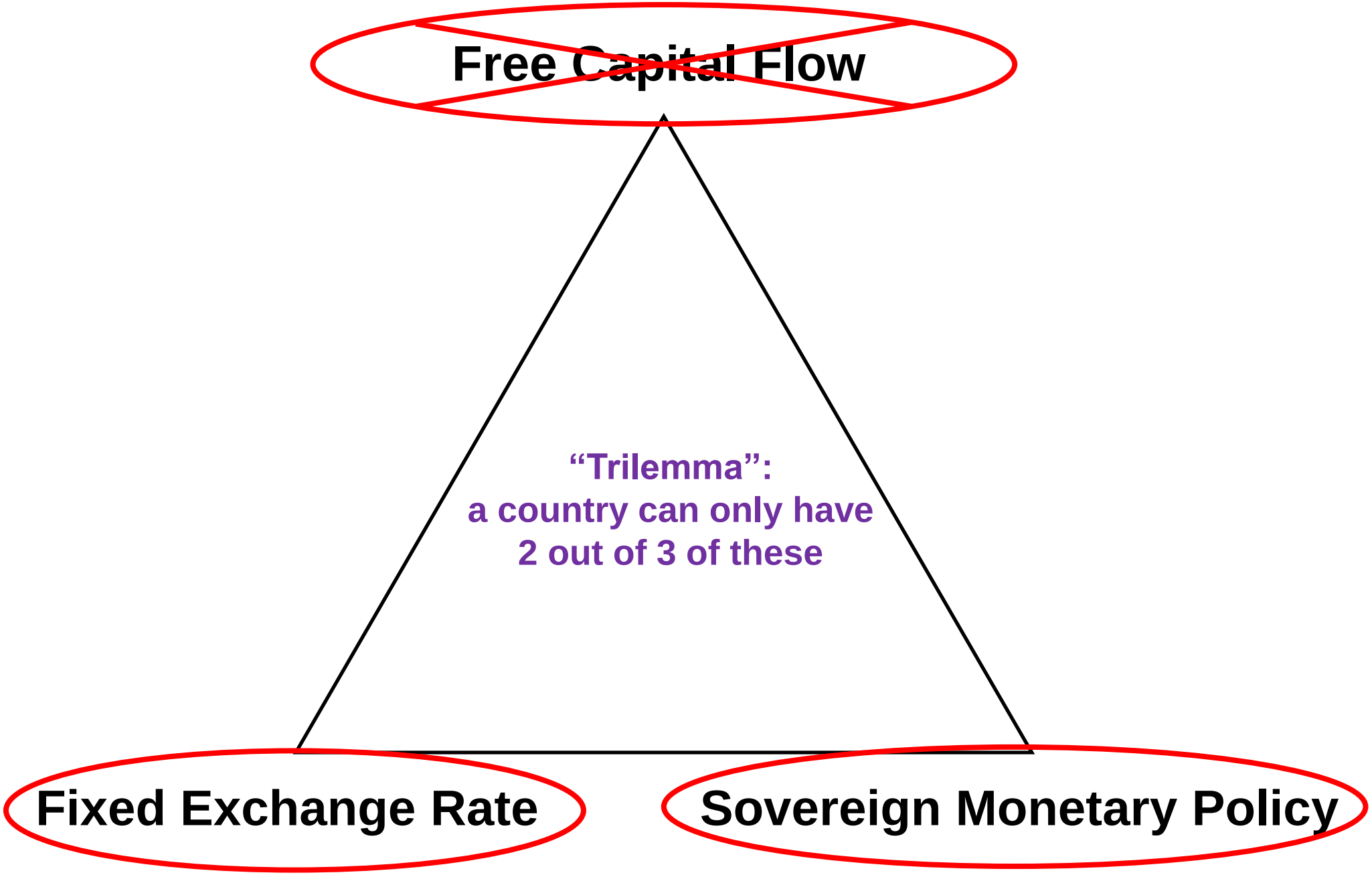


Alternative Commitment:

Independent Central Banks (CB):

Appointed for long terms

Don’t face electoral pressures


Free Capital Flow
"Trilemma":
a country can only have
2 out of 3 of these
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Commitment Mechanisms

- Central bank independence measured:
  1. CB's freedom to decide which economic objectives to pursue
  2. CB's freedom to decide how to set monetary policy (in pursuit of the above objective)
  3. Whether CB decisions can be reversed by other branches of the government
- Examples:
  - Swiss National Bank – highly independent
    - No provision whatsoever for the government to influence monetary policy
  - Reserve Bank of Australia (former) – highly subordinate
    - Secretary of the Treasure has final authority over monetary-policy decisions & must approve any interest-rate changes proposed by the Reserve Bank
- Does it work? Consider Oatley p384, fig 13.5
- Also consider Oatley p387-388, figs 13.6, 13.7

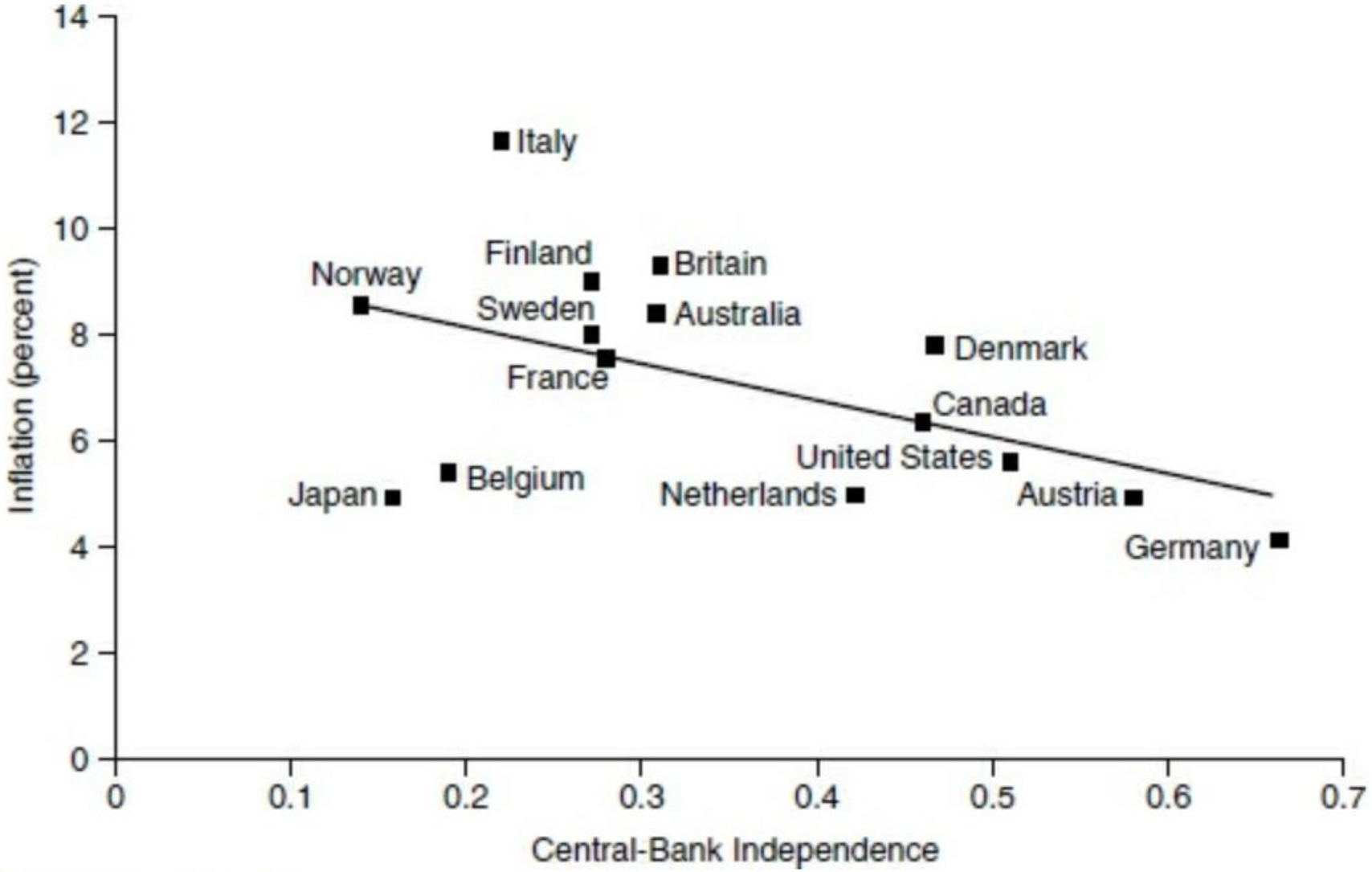


FIGURE 13.5

Central-Bank Independence and Inflation, 1969–1995

Source: OECD 1995 and Cukierman 1992. Higher index values indicate greater independence.

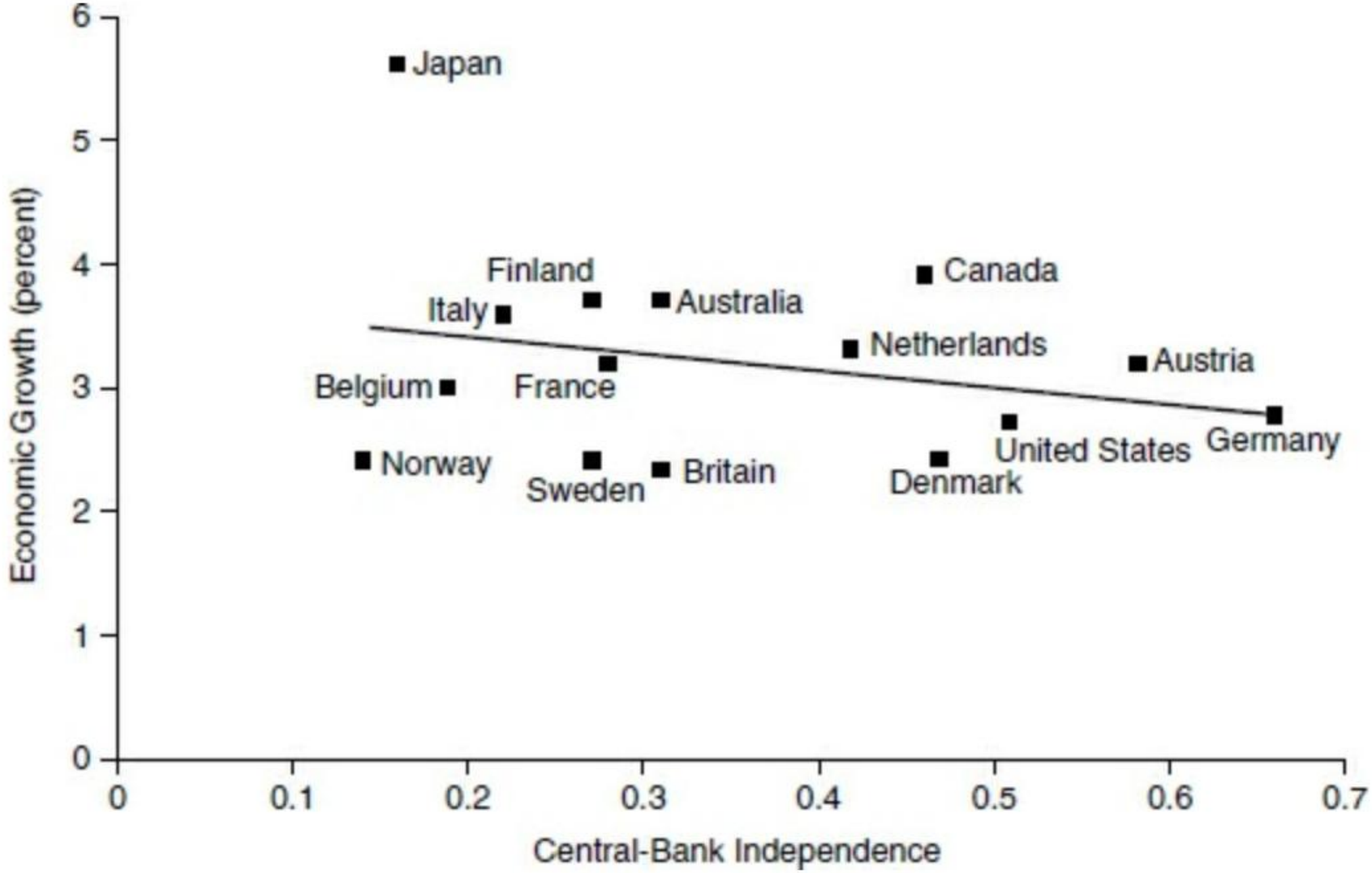


FIGURE 13.6

Central-Bank Independence and Economic Growth, 1969–1995

Note: Higher index values indicate greater independence.

Source: OECD 1995 and Cukierman 1992.

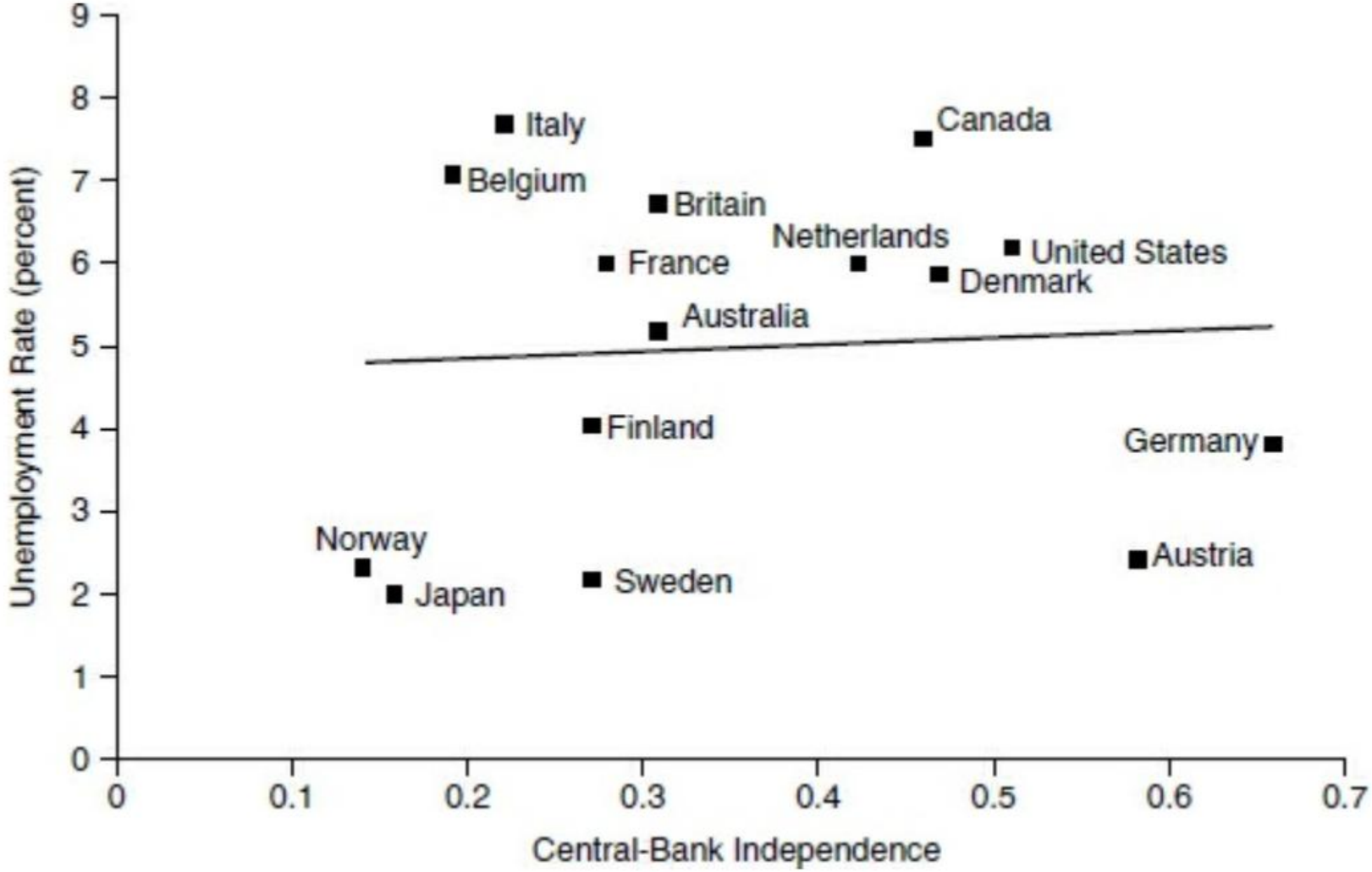


FIGURE 13.7

Central-Bank Independence and Unemployment, 1969–1995

Note: Higher index values indicate greater independence.

Source: OECD 1995 and Cukierman 1992.

Good News/Bad News

- We can “commit” to low inflation with independent central banks
- But independent central banks do not have much influence on economic growth/employment

Solving Time-Inconsistency Problems

- Commitment!
- Is the commitment credible?
- Fixed exchange rate
  - Is the XR really fixed?
- Independent central bank
  - Is the CB really independent?

Solving Time-Inconsistency Preference Problems

- Exams force students to study – solves their time-consistent preference problem
- But the prof has a time-consistency problem too!
- The day of the exam, my optimal strategy is to cancel the exam
  - I can use my time for other things
  - Students are also better off – they did their studying, but are spared the exam-anxiety
- But if I canceled all my exams, my reputation would suffer
- Imagine you had heard that I often cancel my mid-term, would you have studied?
- Then the exam would not have worked to solve ***your*** time-consistency problem
- So my campus reputation encourages me to be credible

https://www.youtube.com/watch?v=nRCyQzBlIzw

Federal Reserve Board of Governors

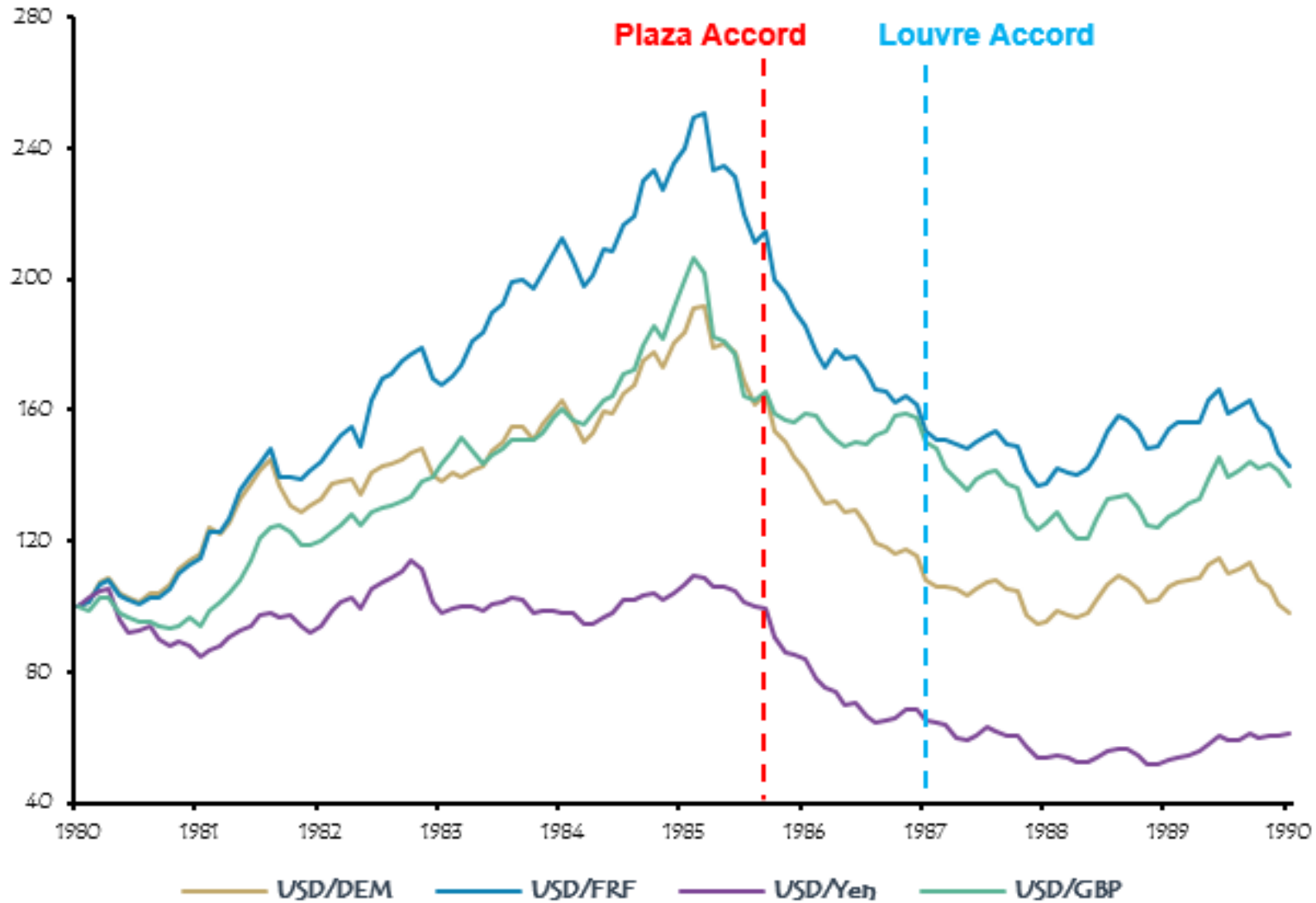
- Nominated by the President
- Confirmed by the Senate
- 14-year term (non-renewable)

Portrait	Current governor	Party	Term start	Term expires
	Jerome Powell (Chair)	Republican	February 5, 2018 (as Chair) May 23, 2022 (reappointment)	May 15, 2026 (as Chair)
			May 25, 2012 (as Governor) June 16, 2014 (reappointment)	January 31, 2028 (as Governor)
	Philip Jefferson (Vice Chair)	Democratic	September 13, 2023 (as Vice Chair)	September 7, 2027 (as Vice Chair)
			May 23, 2022 (as Governor)	January 31, 2036 (as Governor)
	Michelle Bowman	Republican	November 26, 2018 February 1, 2020 (reappointment)	January 31, 2034
	Christopher Waller	Republican	December 18, 2020	January 31, 2030
	Lisa Cook	Democratic	May 23, 2022 February 1, 2024 (reappointment)	January 31, 2038
	Michael Barr	Democratic	July 19, 2022	January 31, 2032
	Adriana Kugler	Democratic	September 13, 2023	January 31, 2026

Why is the US dollar special?

Overvaluation of the Dollar

- International reserve currency
- Early 1980s: Reagan's fiscal expansion – cut taxes, increased spending ➔
- Current account deficit ➔
- Increased interest rates and capital inflows (from, e.g., Japan)➔
- Value of the dollar goes up!
- Plaza Accord (fall 1985): G5 agreed to reduce the value of the dollar against the yen & mark by 10-12% – sell dollars if it appeared the value was going to increase
- By early 1987, dollar had depreciated 40%


Plaza Accord
Louvre Accord
280
240
200
160
120
80
40
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
USD/DEM
USD/FRF
USD/Yen
USD/GBP

Similar Situation Today

- US twin deficits: fiscal & current account
- Japan, Europe, China, current account surpluses ➔
- Finance the American deficit

What's the worry?

- Catastrophe!
- Doubts about the solvency of American financial institutions & American assets➔
- Foreign lenders reluctant to continue to accumulate dollar-denominated assets➔
- Trigger massive sales of current holdings?

Reuters

US bond rout leaves investors bruised despite Trump pause on tariffs

Selloff at some points reached levels not seen since 2001; 10-year auction comes within expectations, in relief; Traders point to forced but...

5小时前

The Guardian

Dramatic sell-off of US government bonds as tariff war panic deepens

Falling demand suggests loss of financial confidence in US as Donald Trump escalates trade standoff with China.

13小时前

FT Financial Times

US Treasuries sell-off deepens as ‘safe haven’ status challenged

Treasuries sold off on Wednesday as President Donald Trump's tariffs took effect, deepening investor concern about the “safe haven” status...

17小时前

BBC

Trump tariffs spark US government debt sell-off

Confidence in the US economy is plummeting as investors dumped government debt amid growing concerns over the impact of Donald Trump's...

6小时前

Thank You!

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Take-away

1. Phillips curve
2. Commitment problem
3. Solutions:
   - ❑ fixed exchange rates
   - ❑ independent central banks