TIGER

TRANSFORMATION, INTEGRATION and GLOBALIZATION ECONOMIC RESEARCH

CENTRUM BADAWCZE TRANSFORMACJI, INTEGRACJI I GLOBALIZACJI

TIGER **Working Paper Series**

No. 118

Exit Strategies

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Warsaw, January 2010

EXIT STRATEGIES

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Overview

The global crisis of 2008-2009 has been a seismic upheaval at least as devastating – in its first eighteen months – as that of 1929-32. The fundamental difference between the two crises has been the policy response of world governments, central banks and international financial institutions. Contrary to what happened in 1929-32, or during the transition recession of the early 1990s, there has been a massive macroeconomic intervention, monetary and fiscal, national and international, jointly undertaken and globally coordinated. Uncharacteristically, a leading role has been taken by the IMF. It is hard to believe that the IMF, until now the global guardian of economic orthodoxy, has learned so quickly a Keynesian lesson from the recent failures of the hyper-liberal model. It is much more plausible to infer that the IMF adapted its stance quickly and effectively in the interests of the USA and its other controlling shareholders. The need for a coordinated large scale effort was so generally understood that the G-20, the IMF, the Fed and European Central Bank all acted in unison – at the April 2009 meeting of the G-20, before and after.

Such an inordinately large, coordinated macroeconomic intervention cannot be regarded as sustainable over the long run. This does not necessarily mean that it should not be prolonged for a considerable time yet, if necessary: there is no need to ever restrict one's choice, in the short and medium run, only to policies that are sustainable indefinitely – as long as they are predictably reversible and are reversed when circumstances change. But this is where governments, central banks and international financial organizations differ profoundly: in their perception of when, how, and how fast to "exit". Policy differences are discussed in terms of "Exit Strategies". The IMF is still standing firm, pointing out that the collective nature of the intervention is a precondition of its success. The position of the Federal Reserve is one of wait-and-see, while reviewing its policy instruments for a swift exit when the time comes - but not yet. The European Central Bank would be keen to return to monetary non-accommodation and fiscal austerity. Germany is already moving towards the exit, strong of the recent ruling of its Constitutional Court that prohibits budget deficits. Australia has already raised its interest rates, causing the dollar to fall and gold price to rise briskly. The Japanese central bank has announced the reconsideration of their extraordinary quantitative easing measures on 30 October 2009.

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In this note the positions of these institutions are reviewed, together with the relative merits and weaknesses of their arguments, with the conclusions that

1) *exit is premature*, because there still is a demand shortfall of the order of 3% of US GDP due to new savings of US households; unemployment will continue to increase well into the second half of 2010, and inflation is not a risk as prices have been falling and both asset prices and wages are under control;

2) whatever the timing of exit strategies, a *coordinated exit*, in the sense of a globally agreed simultaneous exit, *is the worst conceivable policy*; fortunately the individual approaches of the various governments and institutions are sufficiently diversified to make a stampede rather unlikely.

A serious response to a serious crisis

Eichengreen and O'Rourke ((Vox.eu 6 April, updated 4 June 2009) have tracked down the course of both the crisis of 1929-32 and that of 2008-2009, taking as their starting points the earlier peaks in world industrial production, which occurred respectively in June 1929 and April 2008. Month after month, in terms of industrial output, Stock Exchange values and international trade volume, our current recession has replicated the trends of 1929-32 or has been worse. Signs of improvement appeared in mid-2009 but the latest levels to which our recession has plunged in 2008-2009 are still below the corresponding levels reached at the equivalent time in 1929-30. Trade destruction, in particular, has been much deeper than in 1929-32: world trade fell by 17 per cent just in the last quarter of 2008 (FT, 5 September 2009), much faster than the fall in world GDP of approximately 2% in 2009, thus reducing for the first time since WWII the most common measure of globalization, the ratio between world exports and world income.

The fundamental difference between the two crises is in the massive global macroeconomic intervention jointly set in motion in particular by the G-20 of April 2009 but also before and after. Monetary policy has responded faster and more strongly in the present crisis: in 7 major countries interest rates have been cut more rapidly, from a lower level, down to unprecedented low levels. In 19 major countries money supplies in the run up to the beginning of the current crisis had been growing faster than before 1929, but the expansion has continued to be faster in 2008-2009, moreover without any prospect of the money supply contraction of 1929-32 (Eichengreen and O'Rourke, 2009). Short-term interest rates have been driven to almost zero in the US, Japan and Canada, and generally under 1% in Europe. Government budgets have been running consistently higher deficits than in 1929-32, on a world basis, especially in the advanced countries, but also in emerging countries.

It is estimated (*World Economic and Social Prospects-Update as of Mid-2009*) that, since September 2008, governments worldwide have made available massive public funding (amounting to $18 trillion, or almost 30 per cent of WGP [World Gross Product]) to recapitalize banks, to acquire ownership stakes in ailing financial institutions, and to provide ample

guarantees on bank deposits and other financial assets. Further, recognizing the inadequacy of these monetary and financial measures to stave off a recession, many countries have also adopted fiscal stimulus plans, totaling about $2.6 trillion (about 4 per cent of WGP), to be spent over 2009-2011. The amazing scale – absolute and relative – of the global response to the current financial crisis is dramatically illustrated by a simple comparison. According to the United Nations Millennium Campaign, "since the inception of aid (overseas development assistance) almost 50 years ago, donor countries have given some $2 trillion in aid. And yet over the past year, $18 trillion has been found globally to bail out banks and other financial institutions. The amount of total aid over the past 49 years represents just eleven percent of the money found for financial institutions in one year." (Deputy Director Sering Falu Njie, 24 June 2009). Yet this immense effort may still "fall short of the stimulus of 2 to 3 per cent of WGP per year that would be required to make up for the estimated decline in global aggregate demand. " (WESP-Update mid 2009, cited).

Most of the US$ trillions pledged by governments and institutions are still only on paper or are not yet getting spent. There have been no signs of inflationary pressures, indeed prices have been and still are falling globally. There are some signs of a slowdown and the beginning of recovery in some sectors and countries, but unemployment still has to reach its peak in 2010; it is hard to envisage a sustained recovery without unemployment falling.

Thomas Palley (FT, 11 October 2009) uses a most effective metaphor to characterize the crisis, in which a car symbolizes the economy: "Borrowing is like stepping on the gas and accelerates economic activity. When borrowing stops, the foot comes off the pedal and the car slows down. However, the car's trunk is now weighed down by accumulated debt so economic activity slows below its initial level."

"With deleveraging, – Palley continues – households increase saving and re-pay debt. This is the second step and it is like stepping on the brake, which causes the economy to slow further, in a motion akin to a double dip. Rapid deleveraging, as is happening now, is the equivalent of hitting the brakes hard. The only positive is it reduces debt, which is like removing weight from the trunk. That helps stabilise activity at a new lower level, but it does not speed up the car, as economists claim."

Moreover, the car metaphor assumes that the braking process is smooth, while in reality it can lead to a downward spiral turning recession into a depression. Thus Palley proposes the metaphor of the Titanic, "which was thought to be unsinkable owing to its sequentially structured bulkheads. However, those bulkheads had no ceilings, and when the Titanic hit an iceberg that gashed its side, the front bulkheads filled with water and pulled down the bow. Water then rippled into the aft bulkheads, causing the ship to sink."

Hence the importance of a continued macroeconomic policy of fiscal stimulus, plus low interest rates, and quantitative easing in monetary policy, to prevent the sinking. Yet the enlightened

world leaders who engineered the global macroeconomic response are getting worried and impatient. Worried about inflation, impatient about withdrawing from a policy unsustainable in the long run, and tempted by an early individual withdrawal that will give them the benefits of the others' continued intervention.

Exit Strategies

One of the most important items on the agenda of L'Aquila G-8 meeting of 8-10 July was the discussion of the appropriate exit strategy. German Chancellor Angela Merkel was the first to raise the issue of a collective exit strategy. Apparently Barak Obama, Nicolas Sarkozy and Gordon Brown responded negatively, wishing to continue to implement the stimuli and deeming the exit premature. No common strategy was eventually agreed, national governments retaining total discretion over their own exit policy, which is exactly what would have happened without the G-8.

In the United States the $789 billion Economic Stimulus package finally approved on 17 February ($507 billion spending and $282 billion tax relief) is being implemented rather slowly. By early July, $158 billion expenditure had been committed, only one third of that actually spent, plus temporary tax cuts totalled $43 billion; the bulk will be spent in 2010 (NYT, 9 July). "A debate had developed over whether the stimulus bill was having the desired effect or not, with some economists and Democrats arguing that a further economic boost was needed, and many Republicans saying that the rise in unemployment was proof that Mr. Obama's approach had failed. Concerns were also rising about whether the surge in government debt would lead to higher interest rates that would undo much of the effect of the package." (ibidem).

By mid-2009, out of France's $36 bn stimulus package 50% was already spent and a further 25% is due in the second half of 2009, with the last 25% in 2010. In Germany two stimulus packages were worth a combined €81bn. Both countries are sticking to their plans but "appear determined to resist a further large-scale discretionary boost to their economies" (Ben Hall and Chris Bryant, FT 21 July). German attitudes may change after the new government is installed, though a recent decision of the German Constitutional Court has tightened fiscal rules.

The same division on the urgency of exit characterises the position of official financial institutions.

The IMF

The IMF used to be criticised – rightly I believe – for its responsibilities in past crises such as the post-socialist transition recession of the early 1990s, the South East Asian crisis of 1997, the Russian crisis of 1998 (see for instance Joseph Stiglitz, *Globalisation and its Discontents*, 2002). *But times have changed and so has the IMF*, which played a leading role in the current initiative for a global fiscal stimulus, first proposed by IMF Managing Director Dominique Strauss-Kahn at the emergency summit of G-20 leaders on 15 November 2008. On that occasion the focus

shifted from rescuing failing financial institutions to supporting domestic demand, which had fallen off sharply almost everywhere: a global fiscal stimulus of the order of 2% of global GDP was first mentioned.

In an interview with IMF Survey Online on 29 December 2008 Olivier Blanchard, the IMF Chief Economist, and Carlo Cottarelli, Director of the IMF Fiscal Affairs Department, fleshed out the call for such a global fiscal stimulus. Blanchard listed three parallel sets of measures necessary for the recovery. First, banks' recapitalization and isolation of bad assets, in order to resume a sustained flow of credit; he recognised that the measure was complex and might have taken some time.

Second, "the use of monetary policy to increase demand", except that "room for further monetary easing … is shrinking: in some countries, policy interest rates are approaching zero. Moreover, the effect of lower interest rates on demand is weakened by the disruption in credit markets. This points to a central role for the third set of measures, fiscal stimulus. In the short run, such a stimulus, if designed right, can limit the decline in demand as well as output". Was this not rather against the grain of IMF traditional policies? "In normal times, the Fund would indeed be recommending to many countries that they reduce their budget deficit and their public debt. But these are not normal times, and the balance of risks today is very different."

"If no fiscal stimulus is implemented, then demand may continue to fall. And with it, we may see some of the vicious cycles we have seen in the past: deflation and liquidity traps, expectations becoming more and more pessimistic and, as a result, a deeper and deeper recession. If, instead, a fiscal stimulus is implemented but proves unnecessary, the risk is that the economy recovers too fast. Surely, this risk is easier to control than the risk of an ever deepening recession."

Olivier Blanchard then goes further: "I would put it even more starkly. What is needed is not only a fiscal stimulus now but a commitment by governments that they will follow whatever policies it takes to avoid a repeat of a Great Depression scenario. If they do so, the fear that people and firms have today will fade, and demand will pick up. "

The IMF would take a lead in coordinating the fiscal stimulus. "When economies are linked by a high degree of trade openness, fiscal expansion in one country translates in part into an increase in demand for the goods of other countries, and so may result in a larger trade deficit. Thus, each country is, rightly, reluctant to embark on a fiscal expansion on its own. The best solution is for all countries to act jointly. But this requires some form of commitment or coordination. This is why the IMF has been closely engaged in discussions with member countries on how to design an appropriate fiscal response. Given our global membership, we are uniquely placed to do so." In other words, Maynard Keynes is alive and well and inspiring the IMF.

To put its money where its mouth was, the IMF raised its lending commitments to a record $157 billion. It loosened the conditionality attached to its programmes, both on fiscal policy and on

inflation (for instance in Hungary in October and in Iceland in November 2008). It sought "to take account of the needs of the most vulnerable by developing or enhancing social safety nets."(*A changing IMF, Factsheet*, May 2009). It is seeking to triple its lendable resources to $750 billion; to this purpose it has raised much of its $250 billion target in bilateral government loans (Japan $100 billion; Canada $10 billion, Norway $4.5 billion; EU members have committed around $100 billion, and Switzerland $10 billion). It is working at an injection of $250 billion additional liquidity into the global economy, through a general allocation of an IMF Special Drawing Rights (SDRs). The IMF also plans to go ahead with its first issuance of interest-bearing promissory notes to supplement its lendable resources; China is already committed to purchase up to $50 billion, with both Russia and Brazil committing up to $10 billion each (the notes have an initial maturity of three months, extendable for up to five years). The Fund has held discussions with the 26 members of the New Arrangements to Borrow (NAB) and its potential new members about expanding it and making it more flexible. Currently, the IMF can raise about $50 billion through the arrangement, with the U.S. share being about $10 billion. There is an envisaged increase in the NAB of up to $500 billion, of which $100 billion US contribution has already been approved (Andrew Tweedie, the Fund's finance chief, 6 July 2009).

At the end of June the IMF urged "governments to fully implement the spending measures they have announced to combat the global economic crisis and not to relax in supporting an incipient recovery. (John Lipsky, IMF First Deputy Managing Director, in Paris on June 26). For "although experience varied across countries and programs, actual spending of announced stimulus measures was relatively low in many cases." Lipsky paid lip service to the "need to start preparing a clear exit strategy for government intervention in both the fiscal and monetary areas" but said no more than that, not even an inventory of policy instruments like that of Bernanke (see below).

In an interview with Euronews.net on 24 June 2009, Olivier Blanchard reckoned that in the advanced countries the upturn might take place at the end of 2009, with a weak slow recovery "going back maybe to a stable path within three to five years, it's going to take a long time". "Until [the end of 2010], unemployment is going to increase and then, after this, you need growth higher than normal in order to decrease unemployment."

Central banks "have increased their balance sheets enormously. It was largely because they bought assets that private investors did not want to buy. … as the recovery comes, private investors are willing to buy these assets and central banks will be able to sell these assets back to them. So, I am not really worried about the inflation".

"…the fiscal part is more worrisome." "What [governments] should not do is stop the fiscal stimulus now. Because if they did this – private demand at this stage is still very weak – if they stopped, basically, pushing demand, we would probably not see the recovery. So, there has to be fiscal stimulus at least this year, probably next year and maybe even the year after. "

"Surely, now, it is not time to take away the fiscal stimulus or to start increasing interest rates. The economy is very weak, private demand is very weak. If you think about consumers, they are not in the mood to spend. If you look at firms, they are not in the mood to invest. So, if you were to take away the stimulus, you'd basically stop the recovery." "It's absolutely essential for the moment to continue with the monetary policy and fiscal policy that we have had in the last year."

Federal Reserve

In an article in the Wall Street Journal (21 July 2009) the chairman of the Federal Reserve confirmed the consensus within the Fed that "accommodative policies will likely be warranted for an extended period. At some point, however, as economic recovery takes hold, we will need to tighten monetary policy to prevent the emergence of an inflation problem down the road. … We are confident that we have the necessary tools to withdraw policy accommodation, when that becomes appropriate, in a smooth and timely manner".

Nobody ever doubted that the Fed has the necessary tools, it is their smoothness in use that is problematic. Above normal reserves of $800 trillion need to be eliminated or their effects neutralised; their unwinding might take too long without additional measures, such as paying an interest to banks on their reserve balances (which puts a floor - currently at 0.25% - under short-term market rates). If that did not work (because many non-bank financial intermediaries are not eligible for getting such an interest), Ben Bernanke lists four additional instruments. First, "large-scale reverse repurchase agreements with financial market participants, including banks, government-sponsored enterprises and other institutions". Second, "the Treasury could sell bills and deposit the proceeds with the Federal Reserve". Third, the Fed has been authorised by Congress to pay interest on banks' balances at the Fed, which would not be available for the federal funds market. Fourth, the Fed could reduce reserves by selling a portion of its holdings of long-term securities into the open market – a time honoured, classic operation. "Each of these policies would help to raise short-term interest rates and limit the growth of broad measures of money and credit, thereby tightening monetary policy."

This is no exit plan, simply an inventory of exit vehicles, with no indication of timing, scale, sequencing of their deployment. "The Federal Reserve has many effective tools to tighten monetary policy when the economic outlook requires us to do so. As my colleagues and I have stated, however, economic conditions are not likely to warrant tighter monetary policy for an extended period. We will calibrate the timing and pace of any future tightening with the mix of tools to best foster our dual objectives of maximum employment and price stability." In other words, we can and will do it at some point in a distant future, but let's keep the markets guessing – unlike the European Central Bank that has only too often made perverse announcements since its inception, one might add.

European Central Bank

In a key address at Munich University on 13 July, Jean-Claude Trichet stated that "preparations for exit are important. The [ECB] Governing Council will ensure that the measures taken are quickly unwound, and the liquidity provided is absorbed, once the macroeconomic environment improves. Long-term refinancing operations (like operations with shorter maturity) provide liquidity over a fixed time horizon and run off in a fully predictable way. By contrast, the unwinding of outright purchases typically requires an additional decision, namely whether to hold the securities to maturity – and if not, when to sell. The route taken by the Eurosystem limits such decisions to our covered bonds purchases and for the rest relies on built-in mechanisms for the re-absorption of liquidity."

"A return to sound, sustainable public finances, thus strengthening overall macroeconomic stability, must be ensured. Euro area governments should prepare and communicate ambitious and realistic fiscal exit and consolidation strategies within the framework of the Stability and Growth Pact." …

Trichet then puts it even more explicitly and strongly: "I would warn against a common and unfortunate view suggesting that it is currently too early, or even totally inopportune, to envisage appropriate exit strategies. Such a view is, in my opinion, plain wrong – for three reasons:"

"First, because decision-makers' primary quality is that they always display "*sang froid*" and keep their composure, particularly in the most demanding and turbulent times. Viewing today's actions and decisions from a longer-term perspective is part of the necessary intellectual discipline." I believe that this is no reason at all, it is simply monetary *machismo*, of a kind often indulged in by central bankers.

"Second, because nobody should confuse the existence of a credible exit strategy – which can be activated at the right moment – with the decision to actually embark on that strategy. Often such confusion explains people's fierce opposition to the mere existence of exit strategies." My point is that scheduling a surgical operation does not do much to help the patient to recover without it, especially from an illness that depends so much on the patient's morale and will to recover; one might as well provisionally book a funeral.

"And third, because the very existence and the visibility of a credible exit strategy will foster confidence today and will therefore contribute to the re-activation of the economy here and now. This is true for monetary policy: our [euro-area] 329 million fellow citizens are very profoundly attached to price stability in the medium term, and the credibility of our policy is essential for improving their confidence now." *S*urely you don't book a plane until you know when and where you are going, who with and how many, what for and on what budget and how fast you need to get there.

"This is equally true for fiscal policy: economic research has demonstrated that two-thirds to three-quarters of European households are "Ricardian". This means that they consume less and save more if they lack confidence in the soundness of future public finances." And yet, even

those alleged two-thirds/three-quarters “Ricardian” households will not be 100% Ricardian, matching their higher taxes exactly with higher savings. Indeed it seems more rational to respond to higher government expenditure, especially in deficit, with higher rather than lower private expenditure in view of expectations of higher employment and income continuity. I know from introspection that I am 0% Ricardian.

No Deficit, We Are German

The German “fiscal space” has been severely constrained by a decision recently taken in Berlin – unilaterally, without the statutory consultations with EMU partners and institutions – to introduce a balanced-budget law in the German constitution. As if the so-called Stability and Growth Pact were not enough of a fiscal straightjacket, from 2016 it will be illegal for the federal government to run a deficit of more than 0.35 per cent of GDP, and from 2020 the federal states will not be allowed to run any deficit at all. Once this is done, it can only be with a two-thirds majority: “future fiscal policy will be in the hands of the justices of Germany’s Constitutional Court,” while until now structural deficits were allowed by the German constitution as long as they were covered by public investments – the “golden rule” (Wolfgang Münchau, FT 21 June).

Münchau sees the danger that “Germany might end up in a pro-cyclical downward spiral of debt reduction and low growth”… “the prescribed pursuit of a balanced budget would require ever greater budgetary cuts to compensate for a loss of tax revenues. … the new government will have to start cutting the structural deficits by 2011 at the latest. There is clear danger that the budget consolidation timetable might conflict with the need for further economic stimulus, should the economic crisis take another turn for the worse. One could also construct a virtuous cycle … If Germany were to return to a pre-crisis level of growth in 2011, and all is well after that, the consolidation phase would then start in a cyclical upturn.” … “Either of those scenarios, even the positive one, is going to be hugely damaging to the euro-zone. In the first case, the German economy would become a structural basket case, and would drag down the rest of Europe for a generation. In the second case, economic and political tensions inside the euro-zone are going to become unbearable.” …

“…there is no rule in economics to suggest that zero is the correct level of debt, which is what a balanced budget would effectively imply in the very long run. The optimal debt-to-GDP ratio might be lower for Germany than for some other countries, but it surely is not zero. … While the balanced budget law is economically illiterate, it is also universally popular. Average Germans do not primarily regard debt in terms of its economic meaning, but as a moral issue. … The balanced budget constitutional law is therefore not about economics. It is a moral crusade, and it is the last thing, Germany, the euro-zone and the world need right now” (Münchau, cit.)

Burden sharing

A serious side effect of the G-8 inconclusive discussions on a collective exit strategy was that it buried the issues of fleshing out the details of several of the April G-20 proposals; and of the

"fair sharing of the burden of the stimulus among countries" (raised by Jean-Paul Fitoussi and Joseph Stiglitz, Chairmen of "The Shadow GN" – a group of independent experts they set up at Columbia University and the Luiss University in Rome – on "The Ways Out of the Crisis and the Building of a More Cohesive World", May 2009). "To our knowledge, – Fitoussi and Stiglitz say – a state of fair sharing has not yet been reached: the efforts made by the EU, in particular, appear to be well below what should have been done in view of the size of its GDP and high savings rate" (ibidem). Not to speak of the G-8 host country, Italy, the ultimate free rider that never really entered the coordinated reflationary effort, limiting its net participation to a token, miserly 0.8% of its GNP – according to the IMF – plus a few purely cosmetic measures in the very long run, the brainchild of creative accountant Giulio Tremonti, who therefore at L'Aquila was wisely silent on exit strategies in general and Italy's own exit in particular.

A Goldilocks exit strategy?

In an article on "In search of a Goldilocks exit strategy" Jean Pisani-Ferry, Director of the Bruegel Think Tank in Brussels, recognises that "it is still too early to act", and that "against the background of a still very weak economy it is advisable to err on the side of maintaining support for a little too long" [for the non initiated, 'Goldilocks' is economic jargon for a state of the economy which is neither 'too cold' nor 'too hot', thus ruling out both high unemployment and high inflation]. All the same Pisani-Ferry calls for early discussions of an exit's possible course, in order to reassure and calm markets about fears of inflation resurgence, to formulate an appropriate sequence of exit measures, to confront and solve the accompanying problems and to facilitate a coordinated approach. His optimum sequencing envisages first the cleaning up of the banking sector; second, consolidation of fiscal policy, in strict cooperation between governments and central banks; third, the "normalisation" of monetary policy; here he rightly sees monetary authorities reluctant to accept "being hostage to potential government procrastination".

One thing that should not worry us at all is the lack of exit strategies coordination. That the stimuli should be coordinated simultaneously on a global scale was necessary to enhance their effectiveness, but the problem with an exit strategy is precisely the opposite: a simultaneous global exit raises the danger of a cumulative recessionary drive. As long as the exit is not premature and does not turn into a stampede, it is much better if every country goes its own way, staggering their respective exits. The only desirable coordination would be a coordinated staggering of exits - when the time is right - to simulate a random process, instead of an uncoordinated early exit by precisely those countries that have been running the stronger stimuli.

In turn, the coordination between monetary and fiscal policy, recommended by Pisani-Ferry, is desirable at a national level in any case and not just in the exit from macroeconomic stimuli; it should not necessarily take the form of the coordination between an internationally coordinated monetary policy and an internationally coordinated fiscal stance on a global scale. The problem is in the euro area, because the territorial scope of fiscal policy is national and that of monetary policy is European. It is very hard to coordinate the ECB monetary policy with the collective net

fiscal stance of its 16 members – which is what matters – in spite of the so-called Growth and Stability Pact, for this sets ceilings only to individual fiscal stances.

Unsustainable, but why not for as long as it's necessary?

Clearly the current high fiscal deficits, record low interest rates, large-scale monetary easing and other state interventions are not sustainable indefinitely. The general problems surrounding exit measures and their sequencing are worth discussing, as something that sooner or later – let's hope sooner rather than later, for it will imply that the crisis is over sooner – will have to happen at some uncertain date in an indefinite future. But inflation has been falling everywhere to rates unseen for several decades; in the USA, Japan and in the euro area it was down to negative average rates in mid-2009. And even Jean-Claude Trichet says that "Looking ahead, we expect prices to remain dampened over the medium term… all indicators of inflation expectations over the medium to longer term remain firmly anchored in line with the Governing Council's aim of keeping inflation rates below, but close to, 2%." (op.cit.).

Therefore fears of inflation resurgence are definitely exaggerated and premature. Moreover it is not only a question of prices, but also of wages and of asset prices. "Wage deflation seems to have begun even in the industrialised countries. If it continues, it will further depress aggregate demand. Asset price inflation has been the destabilizing factor at the immediate origin of the crisis" (Fitoussi and Stiglitz, cited).

What next?

Pisani-Ferry's preoccupation with Central Banks' likely reluctance to take last place in the correct sequencing of exit steps was soon proven right: on 11 September 2009, at a Bank of Italy Conference in Rome, ECB Board member Lorenzo Bini Smaghi said: "The more delayed the fiscal exit, ceteris paribus, the more the monetary policy exit might have to be brought forward. Indeed, given the level of the debt accumulated in most advanced economies, any delay in the fiscal exit is likely to have an effect on inflation expectations, and may even dis-anchor them. This is a risk that monetary policy cannot take, as it would undermine its overall strategy." (Bini Smaghi 2009 "An ocean apart? Comparing transatlantic responses to the financial crisis"). This does not sound like co-ordination, more like blackmail.

A game is being played, in each country between those responsible for fiscal and monetary policies, and globally between national governments. Each player has a lot to gain in exiting first, both nationally and globally, regardless of what anybody else is doing. Collectively all players have to lose in doing so, with respect to a superior solution in which monetary easing ends after fiscal policy has been tightened, and in an orderly, staggered, gradual and slow withdrawal, country after country, from the collective macroeconomic intervention. It is the classical "Prisoner's Dilemma", and the game is being played too infrequently, and by too many variable players, for a cooperative solution to emerge. This is a formidable test for the fragile beginnings of global governance represented by the G-20 and international financial

organisations: the outlook is pessimistic, with the most likely prospect of double dips, W-shaped or reverse-mirror-imaged-L-shaped curves, rather than a V-shape for Victory over the prospective depression. The sheer official mention of a possible early end to extraordinary measures will reduce and possibly annul the impact of those measures, such as were taken. Given the self-fulfilling nature of pessimistic expectations, loose talk may cause unemployment.