

## Delving More Deeply into Globalization

Dallas Fed Vice President Mark A. Wynne, director of the Globalization and Monetary Policy Institute, discusses the creation of a new research center dedicated to improving policymaking in today's more-open economy.

**Q. Why did the Dallas Fed create an institute to study globalization and monetary policy?**

**A:** Globalization is one of the great economic issues of our time. A massive literature discusses its implications for everything from child labor to climate change. A couple of years ago, the Dallas Fed itself organized a conference that addressed some of the myths and realities of globalization.

However, a lot less has been written about globalization's implications for monetary policy. When Richard Fisher became Dallas Fed president in 2005, he made it clear that he wanted the study of globalization's implications for U.S. monetary policy to be the bank's signature research topic.

At the time this mandate was handed down, our Research Department wasn't well configured to conduct cutting-edge research on globalization and monetary policy. Our small international group had focused mainly on developments in Latin America, and our Center for Latin American Economics had established quite a reputation in this area. We weren't used to thinking about how international developments might matter for the conduct of U.S. monetary policy.

**Q. What do you expect the institute to accomplish through its research?**

**A:** We hope to make some substantive contributions by focusing on the implications of globalization for monetary policy, rather than the much broader questions of globalization. We're committed to conducting research that addresses the key issues policymakers are facing in a world where barriers to economic integration are falling. We will contribute to the peer-reviewed literature on international economics and monetary policy.

We're starting this institute from scratch, but we've already completed five working papers and put several research projects into



motion. One of our economists, for example, is collecting data on IKEA prices around the world as a way to study how firms set prices in global markets and how these prices respond to exchange rates.

When I say that the literature on globalization and monetary policy is less abundant than the literature addressing other aspects of globalization, I don't mean it is nonexistent. A significant body of existing academic research on the conduct of monetary policy in open economies is relevant to our mission, and we expect to add to it.

**Q. What issues does the institute plan to explore?**

**A:** One of my objectives for the coming year is to draw up a research agenda that will serve as a broad outline for our efforts in the coming years. As of now, I see our research program proceeding along two tracks: first, deepening our understanding of the international economy by developing better mod-

els of trade, capital flows and migration and second, developing a better understanding of monetary policy in an open economy.

In more concrete terms, we will be studying the dynamics of the inflation process in the U.S. and asking how it has been impacted by globalization.

I don't buy the idea that large emerging markets can simply export deflation or inflation to the United States; globalization hasn't altered the ability of the Fed to control the price level in the U.S. in the long run. But I do think that increased competition from these countries and their thirst for raw materials affect the pricing decisions of U.S. firms in ways we don't fully understand.

We will also be thinking about how monetary policy ought to be made in an open economy. The Taylor rule relates short-term interest rates to inflation and the output gap, a measure of an economy's unused production potential. It has been a reasonably accurate characterization of Fed policy decisions over the past two decades or so. More important, it has been shown to deliver close to optimal performance in a wide range of settings.

One issue we need to think about is whether the Taylor rule in its current form works well in more open economies. Most research seems to have concluded that even in very open economies, central banks will do a reasonably good job just by focusing on domestic inflation developments and domestic slack. But the issue is far from settled.

**Q. How does globalization alter the process of monetary policymaking?**

**A:** We don't know yet—and that's what makes the institute such an exciting enterprise. We're used to thinking about the U.S. as essentially a closed economy for many purposes, and that remains the default position of many people when they think about U.S. monetary policy.

While the U.S. is less open than many other economies, such as Canada, for example, it has become a lot more exposed to international developments over the years. We are trading more with the rest of the world,

*“As we have become more integrated with the rest of the world, some of the relationships that have traditionally guided monetary policy deliberations seem to have changed.”*



we are receiving enormous capital flows from the rest of the world, U.S. firms are investing more overseas, and we continue to be the destination of choice for many emigrants.

As we have become more integrated with the rest of the world, some of the relationships that have traditionally guided monetary policy deliberations seem to have changed. For example, domestic inflation developments seem to have become less correlated with measures of domestic slack, and not just in the U.S.

Some argue that this is simply a reflection of better monetary policy around the world, while others argue that the relevant measure of slack is global rather than national. I'm not sure which explanation is the better one—both have their merits. But figuring out which is correct is an important challenge.

**Q. Why a separate institute?**

**A.** The main benefit of creating the institute is to underline our commitment to this research program and make it easier to achieve a critical mass by drawing on both internal and external resources.

Our first priority was to hire staff with technical expertise and research interests in open economy macroeconomics. We've

been very successful in this regard, and the five economists we've brought on board over the past two years to further President Fisher's research program are the core of the new institute. Mike Cox, the Dallas Fed's chief economist, is one of the institute's senior fellows.

We don't intend to isolate ourselves from the rest of the Research Department. The staff economists affiliated with the institute participate fully in the department's core activities—especially the briefing process that helps prepare President Fisher for the policymaking meetings of the Federal Open Market Committee.

I think it is important to have the economists working to understand the implications of globalization for monetary policy actively engaged in the regular discussions of policy. Participation in these briefings can be a useful source of ideas for research and allows the economists to bring their research findings to bear on policy discussions.

**Q. You've also been able to draw talent from outside the Dallas Fed.**

**A.** Yes. This is one of the great advantages of creating an institute, rather than working exclusively within the Research Department.

It gives us a greater opportunity to tap the expertise of some of the economics profession's experts on the important issues of globalization and monetary policy.

Our advisory board includes several eminent scholars, who will guide our research efforts and be a resource for us. Stanford University's John Taylor, who formulated the Taylor rule, is the chairman.

Finn Kydland, a long-time Dallas Fed consultant, won the Nobel Prize in economics, in part for work he did emphasizing the need for rule-based monetary policy. Kydland has also made seminal contributions to business-cycle theory and international macroeconomics. A board of this caliber provides the institute with instant credibility.

In addition to the core group of economists at the Dallas Fed, we already have two external senior fellows—Michael Devereux from the University of British Columbia and Frank Warnock from the University of Virginia. We hope to add more during the coming year. The senior fellows will be involved in shaping the research agenda, working with our staff economists and giving us vital feedback on our research.

**Q. How do you see your role as director?**

**A.** My job is simply to make sure things stay on track and get done—from the day-to-day progress on research projects to maintaining the focus on the research agenda and recruiting new senior fellows.

I come from Ireland, and dealing with globalization becomes second nature to those who live in small countries. You have to think about what's happening in the rest of the world and how it affects you. Before becoming the Celtic Tiger, Ireland was one of the poorest countries in Europe and now it's one of the richest, partly because of globalization.

So I find something intuitively intriguing in studying globalization. I see this institute as an opportunity to be part of an effort to examine cutting-edge issues in economics and work with leading scholars, as well as fine young researchers.

