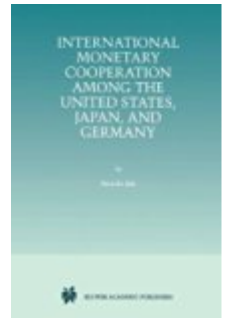
H-Net Reviews
in the Humanities & Social Sciences

Keisuke Iida. *International Monetary Cooperation Among the United States, Japan and Germany.* Norwell: Kluwer Academic Publishers, 1999. 110 pp. $89.95, cloth, ISBN 978-0-7923-8459-5.



Reviewed by Andreas Hippin

Published on H-US-Japan (December, 1999)

This book offers the first book-length study of counterproductive cooperation. With the idea of an Asian Monetary Fund remaining popular and a de facto yen bloc emerging by the beginning of the new century, Iida's book is a must. While students of international cooperation are often taught to assume that cooperation is desirable in principle yet difficult in practice, actual policymakers, for their part, are far from convinced that cooperation is always desirable. In monetary affairs it is almost always contested - in spite of the importance of international monetary and financial stability. Iida is the first economist delivering a comprehensive study of a very particular category of cooperation failure: counterproductive cooperation.

While freeriding, transaction costs and domestic constraints might be named as reasons for aborted cooperation, when states attempt cooperation but fail to reach agreement or fail to comply with such agreements, in counterproductive cooperation states may cooperate for a while, but find themselves worse off than before cooperation.

But why should rational players knowingly cooperate if they'll find themselves worse off afterwards? Why states enter such situations is hard to explain. Iida has to introduce his own definition of international cooperation in order to escape this game theorists' paradox. According to his definition International cooperation is said to have occured if sovereign governments or central banks, in light of interdependence of the monetary and financial policies, attempt a deliberate effort to coordinate their policy, reach an explicit (sometimes underwritten) agreement, and act accordingly. In other words, the three essential elements of cooperation are (1) coordination, (2) agreement, and (3) compliance" (p. 9).

So why does counterproductive cooperation happen at all? Iida names four reasons and classifies the theories of counterproductive monetary cooperation accordingly: third-party effects (or market expectations), perverse incentives, model uncertainty, and international coercion. It's worth to have a look at these theories.

If there are third parties who are not involved in the coordination process but can affect the outcome in a material way, there is no guarantee that cooperation will yield beneficial results, since the excluded parties my react on or preempt the cooperative deal in a negative way. In political economy, the most important third parties are markets: The conflict or lack of coordination between governments and markets is a common theme. Indeed, the essence of the rational expectations revolution in macroeconomics was the proposition that market expectations about official policy might render policy ineffective or produce results that are not anticipated by policymakers" (p. 20). Kenneth Rogoff makes a forceful argument that if monetary policy has an inflationary bias, international cooperation can seriously exacerbate that bias.[1]

A second explanation are perverse incentives or domestic imperfection. Policymakers in the real world will try to maximize the national interest of their country as they perceive it or, simply, as they perceive their own interests, such as reelection. There are models that emphasize a government's noneconomic motives for pursuing policies that may not be desirable from society's point of view. Furthermore, if two or more governments share those pernicious incentives, international cooperation aggravates these biases" (pp. 22). Guido Tabellini [2] and Susanne Lohmann [3] have proposed models illustrating this school of thinking.

Third there might be uncertainty about the payoff of cooperation. According to Iida, the theory of model uncertainty, originally proposed by Jeffrey Frankel [4], is shown to be the most enlightening and robust" (pp.xviii). Frankel simply pointed out that there are significant differences among the various econometric models government economists use to make their economic forecasts. So the expected benefits and costs of cooperation hinge on the model used to forecast the outcome. The intuition is a powerful one: if policymakers don't know what they are doing, it is unlikely that cooperation will improve the situation" (p. 31).

And finally it might result from international power play. Iida believes that even though cooperation may promote the interest of the coercer/signal-sender in terms of material outcomes, the overall result may be worse than noncooperation if one takes into account the cost of coercion (risks that costly punishment has to be imposed in the case of non-compliance) and signaling (costly behaviour to demonstrate resolve" (p. 31).

After introducing these categories Iida examines a vast array of statistical and qualitative evidence in Chapter Three: There is some evidence that growth of the money supply is faster than average in periods of coordination periods (Figures 3-1 through 3-3 in Chapter Three), and that is consistent with the predictions of the Rogoff model. At the same time, however, the inflation rate and the misery index in the G3 countries are not visibly higher, compared with ordinary years. Thus, the statistical evidence is mixed" (p. 100). In case studies Iida examines the Bonn summit agreement of July 1978 which was based on the locomotive theory initiated by the Carter administration in 1977 and the Louvre Accord of February 22, 1987.

Chapter Four adds some more theories on the ineffectiveness and counterproductiveness of concerted foreign exchange intervention and presents both quantitative and qualitative evidence, since coordinated intervention in the foreign exchange market has been another important element of G7 cooperation since the 1970s.

Iida's conclusion will not be popular among realists, intellectual purists and deterministic theorists: Whenever other theories fail emirically, the theory of model uncertainty receives support", he argues (p. xv). It is appropriate to point out, however, that it is impossible to refute a realist critique that the talk of uncertainty is a thinly disguised veil covering over fundamental conflicts of interest. The burden is on these critics to prove that the German and the Japanese as well as the American officials who proposed cooperative packages were certain about the economic consequences of various courses of action (and that there was a near consensus among their predictions). Such evidence is hard to come by", he fends off critics.

Consequently, he argues (1) that uncertainty has to be studied more systematically in the policy-relevant settings rather than just at think tanks, (2) that international monetary cooperation needs careful planning that takes full acoount of the effects of such uncertainty, (3) that hedging and diversification in the policy portfolio" is warranted, (4) that policymakers train with psychologists in coping with uncertainty, and (5) that policymakers should be courageous enough to give cooperation a chance when and only when the possible consequences of noncooperation are immense and the possible costs of counterproductive cooperation controllable" (pp.xv).

Notes

[1]. Kenneth Rogoff, Can International Monetary Policy Cooperation Counterproductive?", *Journal of International Economics* 18, 3-4 (May, 1985), 199-217.

[2]. Guido Tabellini, Domestic Politics and the International Coordination of Fiscal Politicies," *Journal of International Economics* 28, 3-4 (May, 1990), 245-65.

[3]. Susanne Lohmann, Electoral Cycles and international Policy Cooperation," *European Economic Review* 37, 7 (October, 1993), 1373-91.

[4]. Jeffrey A. Frankel, *Obstacles to International Macroeconomic Policy Coordination*, Princeton Studies in International Finance 64 (Princeton: International Finance Section, Department of Economics, Princeton University, December, 1988).