Overview

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The Setting

The Plaza Accord of September 1985 represents the most successful example of international economic cooperation since the Bretton Woods agreement. It was worked out in complete secrecy at the Plaza Hotel in New York City and unveiled to an unsuspecting world on a Sunday afternoon with dramatic effects. Led by the United States, it brought together the world's five leading economies at the time (France, Germany, Japan, the United States, and the United Kingdom) in an unprecedented effort to correct the largest set of global imbalances that had ever threatened the world economy.

The exchange rate of the dollar, which had plummeted to its weakest level ever only seven years earlier and required a massive rescue operation, doubled in value in the five years before the Plaza. As a result, the international competitiveness of the United States was decimated and protectionist pressures exploded in Congress, jeopardizing the global trading system. The US current account deficit soared beyond $100 billion, an unheard of level at the time, and the United States shifted from being the world's largest creditor country to being the world's largest debtor country in less than a decade.

It is difficult, but useful, to recall from our vantage point of 30 years later how profoundly these developments affected thinking around the world. Such global statesmen as Raymond Barre, the former prime minister of France and author of his country's leading economic textbook, and Fritz Leutwiler,

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the universally esteemed president of the Swiss National Bank, stated flatly in early 1985 that "a new world [of international finance] was at hand" and that "the dollar would never again drop below 3 deutschemarks" (it subsequently dropped as low as 1.35).[1] Congressman Bill Frenzel of Minnesota, the thoughtful top Republican on both the full Ways and Means Committee of the House of Representatives and its Subcommittee on Trade, posited that "the Smoot-Hawley tariff itself would have passed overwhelmingly had it come to the floor at that time."[2] The financial, trade, and economic risks were enormous.

The first Reagan administration essentially ignored the problem. Despite growing pleas for remedial action from the rest of the world, and many quarters within the United States, it basked in the boom that led to the president's landslide reelection in 1984 and portrayed the strong dollar as a vote of global confidence in America. Its "benign neglect" and doctrine of nonintervention permitted the problems to rise to unprecedented heights.

Change began in the United States with a change of guard at the Treasury at the beginning of the second Reagan administration. Incoming Secretary of the Treasury James Baker, III and his team saw the tide of protectionism rising in Congress and decided that "item one on our agenda was the dollar" as the only effective policy response (chapter 1 of this volume). Charles Dallara, the senior deputy assistant secretary for international affairs at the time, notes that he and David Mulford, the assistant secretary for international affairs, obtained Baker's approval to undertake intervention to weaken the dollar during Baker's first week in office, in February 1985 (see chapter 4). Mulford describes the total reversal of policy the new Baker team engineered (see chapter 3).[3]

With the threat of US protectionism providing them with enormous leverage, the Treasury worked closely with the rest of the G-5, bringing them to the table to agree to coordinated intervention in September. The immediate sharp depreciation of the dollar after the Plaza Accord generated enthusiasm among the major economies about cooperation that launched more than two years of intensive effort to manage exchange rates and coordinate economic policies more broadly. This ambitious agenda helped revive the institutions for major-economy coordination (primarily the G-5/G-7) that had been fading before the Plaza, largely because of US resistance to the entire process. To some extent, it also institutionalized the role of the International Monetary Fund (IMF) as a neutral participant and adviser in the process. These institutions have survived into the present, though their adequacy for addressing problems in the global economy has been—and remains—an ongoing area of concern.

1. Private conversations with C. Fred Bergsten.

2. Ibid.

3. See also the sharp distinction between "Reagan I" and "Reagan II" in Bergsten (1994).

The idea of the Plaza Accord remains alive today as a major milestone in the history of exchange rate policy. As Takatoshi Ito notes in chapter 7, for the Japanese "the Plaza Accord is as important as fixing the yen to 360 /dollar in 1949, the breakdown of the Bretton Woods regime in 1971, and the breakdown of the Smithsonian Agreement in 1973."[4] Its interpretation remains an important point of debate among international economists because, remarkably, they still refer to the Plaza period when thinking about important policy questions today.

This volume is an attempt to interpret the Plaza Accord with the advantage of 30 years of hindsight. It arose from work commissioned by Rice University's Baker Institute for Public Policy for a conference on the 30th anniversary of the Plaza Accord that was held in Houston October 1, 2015.[5] Fortuitously, the anniversary occurred at a particularly suitable time to examine the current state of affairs in exchange rate policy and global macroeconomic stability in light of the Plaza Accord experience, as indicated in several chapters in this book.

The volume consists of three parts. The first comprises the recollections of several key actors in the Plaza Agreement itself: Secretary Baker, who presented the keynote address at the conference and whose chapter leads off the book; Federal Reserve Chairman Paul Volcker; Baker's chief lieutenants, David Mulford and Charles Dallara, who worked out the details of the Plaza Accord over three months of intense negotiations with the rest of the G-5; and Makoto Utsumi, who played a central role in the Japanese government, the most important of the foreign participants. Several authors of papers in other sections of the book, including Volcker's chief aide Edwin Truman, also offer personal reflections of the period.

The second part of the book offers five analytical appraisals of the Plaza experience by leading experts on international monetary affairs. The third part summarizes lessons from the Plaza by four other experts, each of whom emphasizes in a different way the need for renewed international cooperation to improve the functioning of the international monetary system. Taken together, the 14 chapters provide a comprehensive assessment of the Plaza itself and its implications for global monetary cooperation today and tomorrow.

What Was "the Plaza"?

Interpreting the Plaza Accord and applying its lessons turn out to be complicated. The term *Plaza Accord* encompasses many meanings, as the range of topics addressed in this volume attests.[6] There are at least three: the movement

4. In Japan one can find college-age people who have not studied economics but are familiar with the Plaza Accord.

5. The video proceedings of the conference are available at http://bakerinstitute.org/events/1736/.

6. Even the name *Plaza Accord* remains controversial: The authors of the chapters debated whether it is properly called the *Plaza Accord* or the *Plaza Agreement*. In the end Google played the neutral arbiter: *Accord* beat *Agreement* 102,000 hits to 15,300.

of exchange rates per se, the broader coordination of macroeconomic policies that was attempted, and the institutionalization of international monetary cooperation symbolized by the revival of the G-5 process.

In the narrowest sense, the Plaza Accord refers to the exchange rate activity of 1985, beginning with the shift of the US approach early in the year and ending with the last portion of Plaza-linked intervention and monetary policy reaction. It is also shorthand for the large decline of the dollar from 1985 through 1987 that helped correct the large international imbalances of the mid-1980s. Because it stands as the exemplar of coordinated intervention efforts, this definition of the Plaza engenders debate about whether and how such intervention succeeds. Historical questions, such as when markets perceived the change in US policy and why Japan participated so enthusiastically, remain puzzles with no agreed upon answers.

This narrow definition of the Plaza Accord also provides a useful benchmark against which to judge exchange rate dynamics at any future point in time. Determining whether conditions are ripe for a repeat performance entails evaluating the conditions that led to the Plaza in the first place. The dollar was exceptionally strong, and the exchange rate misalignment was driving large current account imbalances. The real threat of protectionism in the United States, which provided the motivation for all parties to come together and seek a solution, was a direct result. How many of these factors have been matched in other periods, including today? Additionally, for those who are not enamored of freely floating exchange rates, this period provides inspiration that alternative exchange rate policies may be possible.

In a second and broader sense, the Plaza Accord refers to the entire period from the Plaza until at least the end of 1987, including the Tokyo Summit and the Louvre Accord, when the major economies experimented with intensive efforts to coordinate their overall economic policies. This definition of the Plaza refers to a much higher degree of ambition and indeed an effort to build a much more widespread structure. Ultimately, the arrangements attempted under this meaning of the Plaza proved unworkable and unsustainable. They nonetheless provide valuable lessons about the difficulty and limitations of coordination.

In the third and broadest sense, the Plaza stands for an effort to exercise leadership of the global economy by a group of like-minded major countries. The Plaza reinvigorated international coordination in the form of regular, concerted conversations among the G-5 about the global economy and evaluation of joint action on many fronts beyond exchange rate management, which, Mulford argues, paid important dividends in dealing with separate issues, such as Third World debt and the economic dimensions of the end of the Cold War. The Plaza gave the G-5, and soon thereafter the G-7, a prominence that sustained it for at least two decades.

The system of sorts revived by the Plaza did not succeed on all counts. It eroded in the 1990s, and its ultimate denouement came with the global financial crisis in 2007–08, after which the larger and more representative

G-20 succeeded to the title of preeminent global economic policy coordination council. The current lack of functional high-level coordination raises important questions about what should come next. Should another form of the small-group Plaza system return, or should something totally different be created? How should the system accommodate China's prominence or the reality that the international monetary system is shifting from a dollar-dominated system to a multipolar system, as outlined by Agnès Bénassy-Quéré in chapter 13?

For all its shortcomings, the Plaza Accord remains the totem of international economic coordination, providing a metric by which to judge all of these questions. This volume aims to facilitate learning from the past to inform the present, with chapters that relate to all three meanings of the Plaza Accord.

The Narrow Plaza

In the lead-up to the Plaza, there was no doubt about the misalignment of the dollar. Russell Green, David Papell, and Ruxandra Prodan (chapter 8) document its climb beyond the improvement in US fundamentals, with broad support from other authors.

There is less agreement about the historical question of when the Plaza began. The dollar peaked in February 1985, well before the Plaza Accord. Jeffrey Frankel maintains that the markets perceived the shift in US policy as soon as Baker arrived at Treasury (Frankel 1994; chapter 6 of this volume). Others, including Baker and Utsumi, then the minister-counselor for finance at the Japanese Embassy, maintain that the markets were caught completely off guard by the surprise of the Plaza. Our own verdict is that policy changed with the move of Baker but became widely apparent only with the Plaza.

The timing of the market reaction matters substantially to the interpretation of the effectiveness of the Plaza Accord, narrowly defined. The key immediate objective was to bring the dollar down to more reasonable levels against the yen and mark, thereby correcting the very large current account imbalances that had developed over the first half of the 1980s. Whether the Plaza deserves its place in history is disputed, as several authors note, by the substantial decline in the dollar's value over several months before the meeting took place.

Frankel's interpretation rescues the Plaza from this inconvenient fact but raises further questions about its interpretation. The Plaza Accord is synonymous with coordinated foreign exchange intervention, but Frankel's theory suggests that the intervention only emphasized, and perhaps at most amplified, a market reaction that was already well under way. John Taylor (chapter 12) argues that the Plaza intervention was ineffectual and that the dollar would have declined anyway. The main mover of exchange rates in 1985 was the widespread realization that the United States no longer wanted a strong dollar and was willing to intervene to weaken it. Was the Plaza, then, really all about the policy shift in the United States? Perhaps the rest of the G-5 only played the role of blessing the US move, assuring markets they would not attempt to oppose or undo the US action?

Two other chapters provide support for this thesis. In chapter 8 Green, Papell, and Prodan note that the literature on the effectiveness of sterilized intervention finds that it is most likely to have an effect when it is consistent with monetary policy. They proxy monetary policy with a real-time Taylor rule to measure whether the Plaza intervention was consistent with monetary policy in the three key countries (the United States, Japan, and Germany) and find that only US monetary policy supported the Plaza intervention, suggesting that markets were primarily responding to US signals.

In chapter 7 Ito provides results from his earlier examination of where market movements occurred in the week after the Plaza announcement (Ito 1987). He finds that most of the movement occurred in New York and that contemporaneous correlation of intradaily price changes was high in all three currencies. Ito interprets this as evidence that the markets were responding to the shift in US policy, not to intervention undertaken in Tokyo or Europe. He describes how the yen calmed and even began to weaken again after the first week, despite US intervention to buy yen.[7] When the Bank of Japan raised the intrabank rate in late October, the yen began to strengthen again; from that point until the reverse interventions began in March 1986, the market moved in response to Japanese policy comments.

In chapter 6 Frankel summarizes the literature on the effectiveness of intervention (including his own important work with coauthors), concluding that the circumstances of intervention greatly affect its likelihood of success. Some of the factors that appear to improve the likelihood of effectiveness include surprise, coordination with other central banks, and public announcement of the intervention. The Plaza fits well into this pattern. Moreover, the dollar had rebounded shortly before the Plaza, and there had been several other "false starts" in launching and especially sustaining the needed dollar decline. But if the dollar decline was driven primarily by the US component of the announcement, with the rest of the G-5 playing supporting roles and the markets having already digested much of the driving impulse, the interpretation of the Plaza requires a bit more nuance.

Joseph Gagnon adds an interesting twist to the debate on intervention effectiveness in chapter 11. He measures the impact of intervention and quasi-intervention on current account balances rather than exchange rates, in order to capture the important feature that intervention often occurs to prevent rather than propel an exchange rate adjustment. If intervention prevents appreciation—a modern version of "competitive depreciation"—the observable outcome would be a higher than otherwise predicted current account. Gagnon finds economically powerful impacts from intervention and notes that the authorities of a number of major countries, most notably China and Japan but

7. As Ito notes, the Japanese have not released their daily intervention data for this period, so that side of the story can only be estimated.

probably including a couple of dozen others, believe that it works. He notes, however, that the scale of intervention in the 1980s was puny compared with modern intervention and hence probably too small to have had much effect. His interpretation is that the Plaza's impact on exchange rates derived more from the announcements than from the power of the interventions themselves.

Ito's documentation of the Japanese government's persistently propelling yen appreciation in the months after the Plaza raises the question of why Japan participated so enthusiastically in the Plaza Accord. Utsumi describes Japanese Finance Minister Takeshita's involvement in the planning of the Plaza with Secretary Baker months before it took place. Ito cites Gyohten's (2013) recollection that Takeshita pushed for the Plaza communiqué to include more pro-intervention language.[8] For a country with a trade-based growth model, such a course appears counterintuitive.

The universal view of the authors who address the question is that Japan greatly feared US protectionism, much of which was directed against it. Ito cites Funabashi's (1989) discussion of Prime Minister Nakasone preferring a comprehensive solution to the trade problem via exchange rate adjustment over sector-specific trade negotiations. But no one, in Japan or elsewhere, anticipated the extent of the dollar depreciation and especially the massive appreciation of the yen. Utsumi colorfully relays the urgency of new Finance Minister Kiichi Miyazawa to stop the dollar decline in mid-1986.

Ito also describes how the Bank of Japan came to view the exchange rate coordination begun at the Plaza Accord as contributing to Japan's bubble economy and collapse, a view Utsumi supports. This main "negative result" of the Plaza has emerged from some analyses of that period. Ito strongly rejects that conclusion, as do Fred Bergsten in chapter 14 and Frankel. They note that the strong yen was followed by a boom, not a bust, in Japan. The boom and later bust was caused by the low interest rates put in place to counter the Plaza's feared impact on the Japanese economy, which turned out to be unnecessary, and the absence of effective regulation of the Japanese banking system.

Deservedly or not, the narrow Plaza serves as the benchmark for correcting exchange rate misalignments. Large exchange rate movements can be compared with the misalignments seen in the Plaza period, as Green, Papell, and Prodan (chapter 8) and Bergsten (chapter 14) do (including for the current period), to evaluate their potential to motivate coordinated action. But several authors also point out that it takes more than misalignment to produce agreement on coordinated intervention.

The Japanese case highlights the importance of threats of protectionism to motivate countries with undervalued exchange rates to willingly cooperate to appreciate their currencies. Despite the high value of the dollar today—and the congressional debate over currency "manipulation" in 2015, described in chapter 14—Bergsten, Frankel, and Green, Papell, and Prodan all judge the

8. Funabashi (1989) provides anecdotes of similarly aggressive Japanese negotiation during the Plaza meeting.

current situation to lack sufficient risk of protectionist measures to outweigh the harm that surplus countries would expect from promoting a strengthening of their currencies.

Many of the chapters in this volume point out another critical difference between 1985 and today: the relative rates of economic growth in the key countries. In 1985 the German and Japanese economies were expanding comfortably, albeit largely as a result of export booms. Their leadership could afford to take a longer view, accepting that some near-term currency correction would stave off larger protectionist and other problems in the future. By contrast, neither Japan nor the eurozone could probably afford to sacrifice near-term growth today, even if they anticipated future trade friction.

A critical and closely related consideration for undertaking a joint effort like the Plaza is its likelihood of success. In chapter 10 Barry Eichengreen reviews several historical exchange rate agreements to identify key features that have contributed to their results. Governments should have a clear mandate to negotiate, as Baker points out he did at the start of a new presidential term (chapter 2), unlike President Herbert Hoover, who started the failed currency stabilization attempt of 1933 at the end of his term. Modest but specific goals also help; the Plaza aimed primarily and initially only at weakening the dollar with a limited commitment of funds to intervention (which fortunately turned out to be sufficient). Eichengreen attributes the success of the 1936 Tripartite Agreement (signed by France, the United Kingdom, and the United States) to its limited scope. Another of Eichengreen's historical lessons is that all parties must agree on a common diagnosis of the problem. Lack of such consensus contributed to the failure of the 1933 currency stabilization attempt.

Most importantly, Eichengreen finds that coordinated exchange rate policies are much more likely to succeed when the emphasis is on correcting the exchange rate to align with economic fundamentals, not the other way around. He observes this to be the case in the Tripartite Agreement of 1936 and in the narrow sense of the Plaza aiming at near-term correction of misalignment that had strayed far from the underlying economics of the day. Many other authors, including Truman and Frankel, note the same lesson, which applies even more forcefully to the broader meaning of the Plaza Accord as a more ambitious effort at medium-term coordination.

The ultimate judgment on the success of the "narrow Plaza" rests on whether it achieved its two main goals: correcting the large current account imbalances of the middle 1980s and countering the resultant protectionist pressures in the United States, which threatened the continued openness of the global trading system. On both accounts the Plaza was a major if not quite total success.

There was considerable disappointment in the early years after the Plaza that the imbalances remained large, as Truman documents in chapter 9. The US current account deficit continued to grow in nominal terms after 1985, not peaking until 1987. The Institute for International Economics (now the Peterson Institute) convened a major conference in late 1990, entitled

"International Adjustment and Financing: The Lessons of 1985–1991," to assess whether the adjustment process was working as expected and to consider the several theories that were advanced at the time to explain the "failure" of the Plaza. But the three key presentations at that event (Cline 1991, Krugman 1991, and Lawrence 1991), especially the masterful overview by Paul Krugman ("Has the Adjustment Process Worked?"), concluded unequivocally both that the chief imbalances had declined dramatically (if not all the way back to their starting points) and that they had responded to the actual changes in exchange rates in virtually textbook fashion.[9]

The protectionist pressures in the US Congress also largely subsided. The sharp decline of the dollar after the Plaza greatly improved the trade competitiveness of US firms long before the results began to show up in the published data, reducing pleas for import relief or other governmental assistance (Destler 2005). Congress did not pass trade legislation until 1988, and the eventual bill eschewed new trade barriers. It did, however, require Treasury to start making semiannual reports to Congress on exchange rate developments, including the famous (or infamous) mandate to label countries as "currency manipulators" if they violated their IMF commitments to avoid competitive devaluation.

Virtually all of the authors in this volume thus agree that the "narrow Plaza" was a substantial success. An assessment of its overall impact, however, requires consideration of whether it also achieved its broader policy coordination and systemic institutionalization objectives.

The Broader Plaza

The Plaza attempted to coordinate macroeconomic policy adjustment to support and facilitate exchange rate realignment. The United States committed to fiscal consolidation, while Japan and Germany pledged to adopt more stimulative domestic policies. These commitments have faded in the popular memory of the Plaza because they were not memorable—being largely restatements of existing plans—and because the countries themselves largely ignored them or were unable to deliver on them. The authors in this volume unanimously emphasize that altering domestic policies to suit external objectives is rarely successful.

The G-5 nonetheless tried very hard to do so during this period. The Plaza Accord was followed by the G-7 Tokyo Summit of 1986, which represented the most ambitious effort to that time to agree on internationally consistent goals for all the major components of national economic policies, but it also went nowhere. The third step in the process was the Louvre Accord of February 1987, which generated almost a year of concerted effort and instituted target zones (called "reference ranges") for the key currencies; it also eventually ran aground.

9. The elimination of the US current account deficit in 1991 was a one-time phenomenon caused by contributions by several Gulf countries to the United States to help finance the First Gulf War, negotiated largely by then Secretary of State James Baker.

Truman attributes this lack of broader success in part to lack of a common diagnosis of the problem, despite a common identification of undesirable exchange rate movements. The United States saw the exchange rate movements and related current account imbalances originating in the lack of domestic demand in Germany and Japan and therefore saw stimulus in the surplus economies as the necessary correction. Germany and Japan viewed the strong (and then weak) dollar as reflecting the large US budget deficit. Because the divergent views by surplus and deficit countries did not suggest adjustment in their own domestic economies, the finance ministers exhibited little appetite to meet their commitments.

One might cynically argue that the Baker team at the Treasury was not particularly devoted to the idea of coordinating policy. Rather, it opportunistically leveraged fear of protectionism by the US Congress to squeeze more macroeconomic commitments from its trading partners. At the outset of the process, and just after the Plaza itself, the United States did try to use its new willingness to intervene as leverage to get the other countries to expand domestic demand. But Japan, and especially the Europeans, quickly realized that the United States wanted to weaken the dollar for its own reasons and that they did not need to concede much to get it to do so.

The evidence presented in this volume suggests that there was indeed a strong and genuine belief within the Baker Treasury about the benefit of deeper international policy coordination. All the Treasury officials from that period say so and still write today of their desire to see greater international coordination to manage problems in the international monetary system. Frankel and Bergsten both recount the early signs of conversion evidenced by Deputy Secretary of the Treasury Richard Darman, and Paul Volcker agrees that there was a change in thinking in favor of more active international coordination of policies.

In the rest of the G-5, French and Japanese support for systematic coordination of exchange rate policies was evident at least as early as the 1983 Jurgensen Report, according to Truman. Ito notes that Miyazawa, who became finance minister in the middle of the Plaza-Louvre period, was also attracted to the idea of target zones for exchange rates. Treasury Deputy Secretary Darman explicitly endorsed the idea in early 1985. The French hoped to leverage US interests to obtain greater domestic stimulus in Germany (Funabashi 1989). The Japanese were so desperate to garner assistance in stopping yen appreciation that they became the most willing participants in making macroeconomic commitments and arguably demonstrated the best follow-through, as described by Ito.

Germany and the United Kingdom exhibited the least enthusiasm for the broader Plaza. Only 8–9 percent of Germany's trade was with the United States in 1985, severely limiting its desire to sacrifice domestic objectives (Funabashi 1989). The British had even greater ideological reservations but were relatively minor players in the Plaza.

Despite the obvious centrality of monetary policy to exchange rate outcomes, the broader Plaza commitments seldom included monetary policy—largely because of the independence of central banks (with the notable exception of Japan), notes Taylor in chapter 12. Japan allowed some monetary policy commitments to be included in the communiqués, reflecting the dominance of its Ministry of Finance at that time. In contrast, the US and German central banks were able to protect their independence from finance ministers' attempts to formally include them in the negotiated packages. Only Japanese monetary policy shows evidence of supporting the broader Plaza efforts. Indeed, Volcker suggests the Fed explicitly avoided the appearance of supporting Finance Ministry–led initiatives. Truman reminds us that Volcker felt the Plaza reduced the likelihood that the Fed would lower rates, which would help weaken the dollar (chapter 9), and Volcker acknowledges that the Fed could have tightened more than it did to help maintain dollar strength after the Louvre and support its reference ranges (chapter 2).

The difficulties encountered with deeper sustained coordination during this period probably play a significant part in explaining the absence of repeat attempts in the subsequent 30 years, despite serious dissatisfaction with the volatility of floating exchange rates. Bergsten notes that a similar process of macroeconomic coordination was attempted in 2007 under the auspices of IMF multilateral consultations, with even less success. Truman and Frankel conclude that episodic coordination may occasionally work but that efforts to achieve sustained coordination are doomed to fail.

The Plaza as Institutional System

In chaper 14, Bergsten reviews the numerous, mostly unsuccessful, efforts at exchange rate and policy coordination that took place before the Plaza. The institutions for such policy coordination, mainly the G-5, gained credibility from the Plaza itself. The G-5 expanded to the G-7 during the Plaza-Louvre period and continues to exist as a caucus for steering the global economy even today.

But the degree of ambition within the system declined sharply in the 1990s: Less than a decade after the Plaza-Louvre, Bergsten and Henning (1996) wrote a book about "the demise of the G-7." The familiar institutions existed, but their legitimacy, authority, and capacity declined sharply. No author in this volume expresses satisfaction with this outcome.

The resulting nonsystem became characterized by heavy use of exchange rate intervention for mercantilist purposes, especially after 2000, which Gagnon carefully links to strong impacts on countries' current account deficits. Frankel documents the history of US accusations of other countries' currency manipulation, which came to the fore again in the congressional debates over trade policy in 2014–15, despite declining evidence of manipulation. Bergsten describes in detail the legislation linked to the pending Trans-

Pacific Partnership in 2015, which revived the issue and led to potentially important changes in US currency policy.

Taylor and Mulford note that the free-for-all environment of discretionary monetary policy—Mulford calls it a Burkian state-of-nature condition—has encouraged competitive monetary expansions. Taylor describes how these expansions can ratchet one another up through feedback loops. Bénassy-Quéré also shows that, for about half the members of the Organization for Economic Cooperation and Development (OECD), monetary policy does not stabilize real exchange rates. Her results raise the question of whether the current system of discretionary monetary policy has indeed facilitated exchange rate instability. Taylor's comments at the Baker Institute conference indicate his concern that monetary policy has effectively become an instrument for currency manipulation.

The chapters by Frankel and Gagnon take the other side on whether loose monetary policy constitutes manipulation, arguing that its expansionary domestic impact should offset for foreigners any exchange rate advantage low interest rates would provide. Frankel further argues that trade partners are free to duplicate, and hence offset, the impact with their own monetary policy. Gagnon points to IMF research that the impact on emerging markets of advanced economy monetary policy is small and generally positive.

In this void of effective governance, the Plaza Accord harkens back to a time when—for better or worse—major economies had the capacity and enthusiasm for changing the system. The practitioners express a good deal of skepticism about the likelihood of a return to a more managed exchange rate system but issue a clarion call for leadership to modify an environment they view as inherently unstable.

Bénassy-Quéré provides a description of why exchange rate stability matters:

> In fact, exchange rate instability is detrimental to the real economy insofar as it (a) results from abrupt changes in exchange rates that do not allow enough time for domestic producers to adjust, (b) takes the form of long-lasting misalignments rather than short-term volatility, (c) induces retaliation from partner countries that could degenerate into trade and/or currency wars, or (d) is a side effect of asymmetric exchange rate adjustments.... However, monetary stability also extends to the smooth provision of international liquidity, as exemplified during the global financial crisis.

One common refrain in this volume from people in office during the Plaza and others, like Bergsten, who held similar positions earlier, was the critical role of leadership in the broader Plaza Accord. Although the ideas behind more active coordination of exchange rate policies—target zones or reference ranges—had been around for a while and had supporters among the G-5, the US Treasury is universally credited with initiating the Plaza process. Only the United States had the political muscle in the G-5 to play the catalyzing role. It still holds that position, though Dallara argues that a small like-minded group could also provide the necessary leadership. Utsumi sees room for the United States to initiate a Plaza II among the advanced economies similar to what occurred in the Plaza-Louvre period. He estimates that another decade remains when the advanced economies can still call the shots—and believes they should.

But many authors point out that the United States no longer carries the economic weight it did 30 years ago, making it a less potent catalyst. Bénassy-Quéré adds that US economic stature has become particularly precarious because the role of the dollar at the center of the international monetary system has not yet declined, creating an uncomfortable imbalance between the system's structure and its governance.

Today it is not clear which would be the appropriate grouping to lead a call for change. Utsumi opts for the traditional G-5. Gagnon and Bergsten call for a new G-3, made up of the United States, the eurozone, and China, or maybe a G-4, which would also include Japan. Dallara posits a new G-5 that includes India.

Most of the authors, however, note the difficulty of coalition building when the major economies have such diverse backgrounds and objectives. China especially evokes concern as the only major economy without a floating exchange rate and the major currency manipulator since the early 2000s. Bergsten notably adds that "there can be no leadership without followership," a point Utsumi echoes. Convincing partners to follow faces the same challenges as building coalitions of leaders. Would China, probably the new target country today, cooperate nearly as extensively as Japan did at the Plaza? Would Germany, now part of a eurozone that includes a number of very weak economies, be able to cooperate to the extent it did then? There is considerable risk of degeneration into a leaderless, "G-0" world economy of the type that Kindleberger (1973) argues was a central cause of the Great Depression in the 1930s.

Baker, Mulford, and Dallara, the Plaza team at Treasury, all call for a renewed institutionalization of something like Plaza-style cooperation in managing exchange rates and indeed national economic policies more broadly. Green, Papell, and Prodan and Bergsten document that the real dollar is very close to Plaza levels of overvaluation against the yen—and almost as strong against the euro—so that any coordination effort would have to begin with a Plaza-like depreciation of the dollar. They doubt the feasibility of any move to a more cooperatively managed exchange rate system, however, despite the strong dollar environment. What would be the incentives to adopt such a system? The effort would need to be consistent with fundamentals, but the fundamentals at the moment all point toward continued dollar strength, as Eichengreen emphasizes. In the current weak growth environment in Europe and Japan, only tremendous pressure would be able to shift monetary policy to tighten to support a stronger euro and yen.

A second observation regards the traditional source of pressure for currency cooperation, trade protectionism in the United States. Bergsten, Frankel, and Green, Papell, and Prodan all judge that, despite the current congressional attention to currency manipulation in the context of new US trade agreements, pressure has not reached a level that significantly concerns other major economies. Several authors worry that the dollar may rise further and the US current account will deteriorate considerably more, so that such sentiment could escalate as Congress addresses several pieces of trade legislation (for the Trans-Pacific Partnership and probably the Transatlantic Trade and Investment Partnership). But all agree that a "Plaza II," in the narrow sense of the term, is not likely any time soon (Frankel concludes that the prospects for such an initiative are minimal).

There remains the question of whether new institutional reforms should be attempted. What sorts of improvements to the current system would the authors in this volume suggest?

Bénassy-Quéré posits that the rise of alternative currencies to the dollar, of which the renminbi is the most likely, could create a more stable multipolar system. Bergsten favors the congressional effort to incorporate enforceable provisions against currency manipulation in trade agreements, if they could be negotiated, and the unilateral US announcement of a readiness to implement "countervailing currency intervention" against aggressive manipulation. His argument—which Gagnon supported during the discussions at the Baker Institute conference—is that the metrics incorporated in new US currency legislation and described in chapter 14 allow clear, uncontroversial identification of manipulation that eliminates the gray areas that have allowed political factors to undermine the credibility of past efforts to fight the practice.

Gagnon goes further, suggesting a new set of international rules to set limits for foreign exchange intervention. Setting and enforcing such rules could be an appropriate task for the IMF rather than any informal G-7 or G-20 arrangement. He suggests adoption of a system of reference rates (à la Williamson 2015) that provides guidelines for when sterilized intervention should be conducted while avoiding any firm limits on exchange rates or changes in monetary policies. Without going nearly as far, Frankel believes that a time will come for renewed efforts at coordinated intervention to reduce currency instability and especially prolonged misalignments.

Based on his conclusion that intervention is fruitless, Taylor prefers a system in which each country follows its own monetary policy, driven by domestic considerations. To avoid instability, he would add one key element to that monetary policy: that its "reaction function" should be spelled out in fairly clear terms, presumably along the lines of the Taylor rule. As long as central banks mostly follow such a rule, he argues, the system can avoid the distortions and instability inherent in discretionary ad hoc monetary policies.

Conclusion

The Plaza was an iconic moment in the history and evolution of international monetary cooperation. It was uniquely successful in achieving all three of its immediate goals: sharply realigning exchange rates, significantly reducing the global imbalances of the day, and providing an effective counter to protectionist pressures in the United States that were threatening to disrupt the international trading system and the world economy.

The Plaza was less successful in pursuing its more ambitious objectives: extensively coordinating the economic policies of the leading economies and institutionalizing the process of international economic cooperation. It nevertheless made some progress in both areas and added significantly to the long-term trajectory of managing globalization more successfully.

Both the more and less successful aspects of the Plaza produced valuable lessons for what to do—and what not to do—when future problems of international adjustment arise. They provide guidance for how to handle both the economics and, even more critically, the domestic and international politics of such issues. The Plaza remains a cardinal point of reference even today, when the world again faces the prospect of a toxic mix of currency disequilibria, growing imbalances, trade policy reactions, and thus uncertainty for both the global economy and world politics.

The Plaza also represents a rare example of international economic cooperation among the major countries of its period. It thus carries broader implications for governance in a globalizing world and for issues that range beyond economics. It embodies an era that we frequently seek to recreate today.

This volume attempts to recapture the essence of the Plaza experience. It blends the recollections of some of the central architects and implementers of the agreement, analysis of its meaning by several leading contemporary observers, and an assessment of its lasting messages by some of the world's top international economists.

We thank the Baker Institute for Public Policy at Rice University, and especially former Secretary of the Treasury (and later Secretary of State) James Baker, III, for making this effort possible. We hope that it will add perspective and insight to our ability to address the many problems of international monetary policy that we face today and will continue to face for the foreseeable future.

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