Conversations with Visiting Scholars

Prakash Loungani Interviews IMF Fellow Olivier Coibion

Loungani: Congratulations on your selection as an IMF Fellow. Is this your first stint at a policy institution?

Coibion: Thanks, I'm thrilled to be here! I worked for a year at the CEA (U.S. Council of Economic Advisers) in 2000–01. It gave me an enduring sense of how economic theory and empirical methods can help address policy questions and make a difference in people's lives. And because I happened to be there during the transition from the Clinton to the Bush administration, it was fascinating to see the change in style and personalities—and in the dress code. The suits got much more sober and I even had to start wearing a tie once the Bush administration was in place.

Loungani: Dress is casual at the IMF over the summer. You will see the suits out in full force in the fall. What will you work on during your year here?

Coibion: I'll continue some of my work on inequality. One project will look at links between inequality and financial crises, which folks at the IMF have also studied. I've also been studying the impact of monetary policy on inequality—who gains, who loses when the Fed changes its policy. This gets debated in policy circles a lot, but not much in academia. Ron Paul says that expansionary monetary policies, or debasing the currency as he always puts it, raises income inequality; people on the left like Jamie Galbraith say the opposite.

Loungani: What do you find?

Coibion: Expansionary monetary policy has typically reduced U.S. inequality in the short run. This suggests that when the central bank can't cut interest rates any more—when rates hit the so-called "zero lower bound," as is the case at present—inequality will be higher than it would be otherwise. To avoid these additional increases in inequality at a time of crisis, the government should use other tools, such as targeted fiscal policies. I hope to do some more work on this while I'm here. More generally, I'll be studying how best to sequence fiscal and monetary policies when the multipliers—the impact of the policies on the economy—associated with each may vary with the state of the economy.

Loungani: Do you think the Fed has done enough to promote recovery?

Coibion: I think the zero lower bound [on interest rates] has certainly limited the size of their response. They would be lowering rates further if they could. But as the IMF's latest review of the U.S. economy noted, the Fed still has a few options to further support economic activity, given the weak

Surges in Capital Flows: Why History Repeats Itself

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state of labor markets and given the significant downside risks that still exist.

Loungani: Do you think that to avoid hitting the zero lower bound in the future, central banks should raise the target rate of inflation?

Coibion: No, I don't. A higher inflation rate also has economic costs. Therefore, raising the target inflation rate will confer the benefit that we'll be less likely to hit the zero lower bound. But such episodes are rare; and the high benefits conferred on rare occasions have to be balanced against the small but frequent costs of having higher inflation. In some of my research, it turns out that the costs consistently outweigh the benefits for inflation rates above 2 percent. So rather than raise the target rate of inflation to deal with future episodes like the Great Recession, I'd prefer the more aggressive use of temporary policies designed for precisely this kind of episode, such as additional quantitative easing or fiscal policy.

Some Recent Articles by Olivier Coibion

"The Optimal Inflation Rate in New Keynesian Models: Should Central Banks Raise their Inflation Targets in Light of the ZLB?" (with Yuriy Gorodnichenko and Johannes Wieland), forthcoming in *Review of Economic Studies*.

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The LIC-BRIC Linkage: Growth Spillovers

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