these measures through cross-bank transactions.

5. Policy makers should recognize the limitations, fiscal costs, and distortionary effects of instruments such as intervention in foreign exchange markets and even selective capital controls, especially when used for sustained periods. They should not see them as substitutes for structural reform and macroeconomic policy adjustment.

6. When a number of countries undertake measures to intervene in foreign exchange markets, this should be taken as a signal to the proposed committee of central bankers that there are policy inconsistencies at the international level that need to be addressed. These discussions could improve the likelihood of collective solutions that minimize adverse spillovers, or at least reduce the possibility of tit-for-tat escalation—for instance, through trade restrictions or competitive devaluations—that leads to worse collective outcomes.

7. Cash-strapped governments will be tempted to use prudential measures to capture domestic sources of financing (via statutory liquidity requirements on banks mandating the holding of domestic government bonds, for example). Such practices are likely to become increasingly prevalent as governments grapple with the budgetary consequences of high post-financial-crisis debt ratios. This makes it important to recognize that these measures come with risks. They can lead to greater risk concentration (as, for example, when domestic banks become exposed to an insolvent government), something that could prove costly to the global community when the country needs foreign support. Moreover, long-term barriers to cross-border capital movements divert capital flows into less transparent channels, making it harder to undertake adequate supervision.

Conclusion

Our objective in this report has been to lay out a roadmap for central banking in the post-crisis world, where financial stability can no longer be seen as outside the ambit of monetary policy, cross-border spillovers have increased in scope and size, and central banks have come under new pressures. The report sets out a strategy for incorporating financial stability concerns in the implementation of monetary policy without diluting the price-stability objective. It proposes institutional mechanisms for dealing with tensions caused by cross-border spillovers of inconsistent domestically-oriented policies. Finally, it describes how central banks are under pressure from a variety of new mandates and constraints imposed on them by other policies and institutional structures and what they should do about it.

We, of course, recognize that practical central banking differs from the theoretical ideal of flexible inflation targeting and that it may already incorporate some of what we suggest. Still, a framework is needed to articulate and better guide central banking in the more complicated and interconnected world that we now live in, especially in light of the lessons learned from the global financial crisis. By tracing the connections among different facets of central banking, we have attempted to create a broader framework and set out some concrete proposals for making progress.