Comments on

The Global Economy and the Future of the Bretton Woods Institutions



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ICRIER-CEPII-BRUEGEL Conference on 'International Cooperation in Times of Global Crisis: Views from G20 Countries', New Delhi, 14 & 15 September 2009.



1 Institutional questions raised by paper

- Paper analyses the international monetary system
- Paper begins by discussing the relationship between nationalism, open markets and political authority
 - Who is lender of last resort?
 - Who solves collective action problems of illiquidity and insolvency?
 - Question of how what kind of international influence there ought to be over the setting of currency values?
- Paper analyses effect of increasingly integrated markets
 - How should this allocation of responsibility respond to increasing global integration
- Overall this raises important about economic institutions
 - What are the targets?
 - What are the instruments?
 - What targets-instruments is desired



2 Economic Institutions: example of the independent central banks

- Inflation targeting objective
 - Solution of inflation bias problem and, subject to that, management of demand shocks
- Institution independent central bank
- Successful Policy Process (until 2007)
 - use of well specified instrument
 - clear process
 - transparency, accountability, erforcement



3 Economic Institutions: the IMF in the Bretton Woods system

- Bretton Woods objective
 - External adjustment objective
 - enabling countries to pursue high levels of employment and output, by means of demand management policies.
- Institution: IMF
- Process:
 - Clear instrument:
 - Rules-based global system of pegged-but-adjustable exchange rates,
 - Countries would pursue their own domestic policies,
 - exchange rates would be adjusted, to ensure external balance.
 - Aim was for both adjustment and cooperation
 - Outcome only partially successful
 - Deficit countries resisted exchange rate adjustment
 - Surplus countries resisted external adjustment
- Leadership by US: enabled some enforcement



4 The Contemporary Need for an International Monetary *System*

- After the crisis we need a different way of managing macroeconomic policy internationally
- Not just inflation targeting in individual countries, but also policies which
 - do not produce financial boom and bust,
 - do not produce inappropriate fiscal outcomes,
 - do not produce large savings and investment imbalances internationally,
 - do not produce inappropriate exchange rates



4.1 Advanced Economies

- It is necessary to use three policy instruments (interest rate policy, regulatory supervision, and fiscal policy) to achieve three policy objectives
- (i) Interest rates: 'inflation targeting': to stabilise inflation and output.
 - A country with excessive inflation will raise interest rates and the expectation is that this will allow the exchange rate to appreciate. Countries in which demand is too low will, as before, lower interest rates and allow exchange rates to depreciate.



- (ii) Countries will need to regulate their financial systems so as to limit speculative risk taking.
 - This involves a limit to borrowing and to the leverage of financial institutions.
 - It involves an increase in financial regulation which would limit the allowable increases in balance sheets of systemically important financial intermediaries.
 - Such limits will need to be tied to the fiscal capacities of host governments.
 - Without this, the use of interest rates to pursue inflation targets may give rise to the perverse boom-bust outcomes in asset markets.
- (iii) Countries will need to manage fiscal policies sufficiently in line so that
 - rising long term interest rates do not impede forthcoming recovery
 - induce inappropriate exchange rate movements over the medium term.

Policies not self-reinforcing:



but surveillance has so far been of limited effectiveness

Advanced countries: IMF will need improved multilateral surveillance on policies (ii) and (iii)

- On macroeconomics and fiscal policy:
 - the IMF's World Economic Outlook is the natural vehicles for this analysis, coordinated with the IMF's programme of multilateral surveillance.
- On financial regulation
 - the IMF as a macro-prudential supervisor at global level,
 - The IMF should augment Financial Stability Board (FSB)
 - The IMF has a large expert staff, and is universal organization.

4.2

4.2 Emerging Market Economies

In addition the following is required in emerging market economies

- (iv) Abandon pursuit of inappropriate exchange rates
- The IMF would determine the appropriate exchange rate values for countries – 'fundamental equilibrium exchange rates'.
 - Difficult to specify equilibrium exchange rates. (IMF, 2007).
 - Thus, Fund could only activate this requirement if a currency was a significant distance from fundamental equilibrium level.
 - The IMF require countries not to intervene so as to steer exchange rates away from these fundamental values.
 - This would *not* involve an attempt by the IMF to impose, or fix, exchange rates.



- (v) Need new system of provision of international reserves for emerging market economies
- Need to provide credible insurance to countries
 - Central Bank swap lines (Portes, 2009)
 - more ambitious 'reserve pooling' arrangements.
- And should involve a new system of reserve provision
 - The IMF would issue SDRs to emerging market countries,
 - IMF given power to make emergency issues of SDRs to fight crises.
 - making the IMF 'lender of first resort' (Cohen & Portes, 2006).
 - This would go well beyond recent issues of SDRs
- Would remove need for current account surpluses

Policies not self-reinforcing:



but surveillance has so far been of limited effectiveness

Emerging Market Economies: agreement about multilateral surveillance needed on policies (iv) and (v)

- Surveillance could be made mutually reinforcing in emerging market economies.
 - would be possible to link access to SDR financing to countries which were not intervening in such a way as to cause their exchange rates to be greatly undervalued
 - making this provision of insurance an alternative to running large current account surpluses.



5 Governance Implications

- Requires more effective governance of the IMF
 - Removing Executive Board of Fund from Article IV reports.
 - Could strengthen the accountability of the Managing Director and his Deputies
 - Reporting to a strengthened IMFC
- Requires further changes to position of the IMF
 - so that the Fund inspires confidence in emerging market economies.
- That will need changes in the IMF's distribution of power, and voting structure, so as to reflect the changing realities of the world balance of economic power.
- The ad hoc provision of increased quota shares to China, Korea, Mexico, and Turkey in 2006 was a first step
- further steps discussed in run up to April summit
- will require decisions to reduce the shares of others, esp in Europe.

6 Conclusion

Reforming the international monetary system requires understanding of

- targets
- instruments
- process by which the IMF could bring to bear influence over instruments in the desired direction
- How to turn surveillance into capacity to require changes in instruments
- enforcement

Requires turning surveillance into capacity to require changes in instruments

Requires leadership in multi-polar world

Requires a answers to questions about global authority posed by Louis Pauly