International Monetary Reform: What to do Fifty Years after the Collapse of the Bretton Woods System?

Peterson Institute for International Economics

David Vines, Paola Subacchi, Chatib Basri and Jonathan Ostry

April 14th 2023

ONLINE ISSN 1460-2121
PRINT ISSN 0266-903X

OXFORD REVIEW OF ECONOMIC POLICY

Reform of the International Monetary System

VOLUME 39 NUMBER 2 SUMMER 2023

www.academic.oup.com/oxrep

CONTENTS

Fifty years on: what the Bretton Woods system can teach us about global macroeconomic policy-making
Paola Subacchi and David Vines

Lessons from the 1970s for international monetary reform
Barry Eichengreen

From the Bretton Woods system to the global non-system: the trials and tribulations of slow learning
David Vines and Paola Subacchi

European monetary regimes after the fall of Bretton Woods: a political economy approach
Giovanni Farese, Paolo Guerrieri, and Pier Carlo Padoan

The Euro on the global stage
Klaus Regling

The role of China in the international financial system
Haihong Gao

Longer-term structural transitions and short-term macroeconomic adjustment: quantitative implications for the global financial system
Warwick McKibbin and David Vines

Promoting sustainable investment through financial architecture reform
Adam Triggs

Continued

OXFORD UNIVERSITY PRESS

Exorbitant privilege and fiscal autonomy
Paola Subacchi and Paul van den Noord

The International Monetary Fund and capital flows
Stephen Grenville

The IMF's journey on capital controls: what is the destination?
Jonathan D. Ostry

Overcoming 'original sin' to secure policy space
Hyun Song Shin

The impossibility of the impossible trinity? The case of Indonesia
M. Chatib Basri and Luqman Sumartono

Avoiding a lost decade—an interim update
Lee C. Buchheit and Mitu Gulati

Avoiding a lost decade—sovereign debt workouts in the post-Covid era
Lee C. Buchheit and Mitu Gulat

Creating a new sovereign debt reconstruction mechanism: why incentives, risk sharing, and CACs will all matter
Gordon Menzies and David Vines

Development finance cooperation amidst great power competition: what role for the World Bank?
Scott Morris

How will digital technologies influence the international monetary system?
Eswar Prasad

Scan to view this journal on your mobile device

OXFORD UNIVERSITY PRESS

https://academic.oup.com/oxrep/issue/39/2

Speakers

David Vines is Emeritus Professor of Economics and Emeritus Fellow of Balliol College at the University of Oxford and has for many years been a regular Visiting Fellow at the Crawford School of Public Policy in the Australian National University.

Paola Subacchi is Professor of International Economics at Queen Mary, University of London and is Adjunct Professor at the Department of Political and Social Sciences at the University of Bologna. She was Director of International Economics Research at Chatham House for nearly 15 years.

Chatib Basri teaches in the Faculty of Economics at the University f Indonesia. He has been Sherpa to the President of Indonesia for G-20 Meetings, and was the Indonesian Minister of Finance between May 2013 and October 2014

Jonathan Ostry joined the Faculty of Georgetown's Economics Department in August 2022 as Professor of the Practice, following a 34-year career at the IMF, where he served in a number of senior positions, including Deputy Director of Research and Acting Director for the Asia Pacific region.

1 Introductory Remarks: Outline of the *OxREP* Issue

- Following the GFC in 2007-8, leaders of the G20 agreed to promote ‘strong, sustainable, balanced and inclusive growth’.
- Our authors ask:
  - How must the international monetary and financial system change if this goal is to be achieved in the 21st Century,
  - What form of international cooperation is necessary?
  - What kind of leadership is needed in the IFIs (the IMF and the World Bank) and in the G20?
  - In what way might the US, Europe, and China share leadership?
  - What role for ‘innocent bystanders’ in global governance?
- The initial paper by Paola Subacchi and me: “Fifty years on: what the Bretton Woods system can teach us about global macroeconomic policy-making” brings the answers together.

2 The Objectives of an International Monetary System

- We get our first overall answer from Keynes himself
  - what Keynes himself said to James Meade one day, early in 1944, in the run up to the Bretton Woods Conference.
- The story goes like this: an international monetary system must :
  - ensure an adequate level of aggregate demand globally and yet avoid inflation;
  - ensure a workable process of international adjustment of current account balances; and
  - bring about a system of international lending that addresses the needs for both:
    - shorter-term financing of BofP adjustment processes, and
    - longer-term financing of foreign direct investment (FDI)

  in a way is not prone to excessive instability and crises.
- We still share the same objectives that Keynes had, even though we now think that the way to get to them is now different.

3 Some more history

- This meeting of ours follows the extremely successful conference on 50 years of floating exchange rates, held at the PIIE on 23/24 March.
  - Details of that meeting can be found on the Peterson Institute Web site
- The first session of that meeting involved a fascinating recollection of the confused discussions in the early 70s, at the “Committee of 20”, of how to reform or rebuild the Bretton Woods system.
- We have in this issue of *OxREP* an extremely interesting paper by Barry Eichengreen, unpicking these unsuccessful discussions. Eichengreen concludes that there was:
  - no agreement on a new exchange rate regime or system.
  - no agreement on creating a more symmetric adjustment mechanism
  - no global regulation of international liquidity.
  - no enhanced role for the SDR.
- The result was what we now call a non-system.
- …..but there is more to the story than this.

… even more history

- Paola Subacchi and I argue that the real trouble was that those negotiating in the early 1970s did not understand what they were aiming for.
- A system of floating exchange rates can only be made to work if there is a successful form of anti-inflation policy providing a proper nominal anchor.
- This process took 20 years, and involved a flirtation with monetarism, before finally, ending up with the inflation target system which advanced countries in the world now all have.
- Only when the world has a nominal anchor like this in place that the world can safely manage a system floating exchange rates. This talk of an enormously long time to learn

… and yet more history

- We also have a very interesting historical paper on Europe by Paolo Guerrieri, Pier Carlo Padoan and Givanni Farese
- This describes how and why countries within the European Union rejected the ideas that exchange rates between then should float
  - They came to believe that the single European Market was inconsistent with floating exchange rates amongst European countries.
  - Instead, these countries attempted to fix exchange rates between them, in a way which eventually led to a monetary union.
- This paper provides a very useful introduction to the very helpful paper by Klaus Regling about the role which EMU now plays in the global financial system.

4 Looking Forwards – two sets of challenges

- We four speakers believe that there are two main sets of challenges facing the global financial system, in relation to:
  - advanced countries (which Paola and I will talk about) and
  - for EM economies (which Dede and Jonathan will discuss).
- It is good to be having these discussions here at the time of the IMF and World Bank Spring Meetings. Many of the sessions at HQ1 and HQ2 in 19th Street have shown that these two sets of challenges both sets of countries are closely interconnected.
- Let me now set the stage by talking briefly about the core challenges facing advanced countries before passing the floor
  - first to Paola to discuss these challenges for advanced countries in more detail
  - and then to Dede Basri and Jonathan Ostry to discuss challenges facing emerging market economies .

5 Advanced Countries: Large Prospective CA deficits

- The world faces:
  - global demographic transition
  - A long term slowdown in productivity growth and
  - a rise in investment in renewable sources of energy necessary to help ensure zero global emissions of carbon by 2020.
- The paper by Warwick McKibbin and me shows empirically that these shocks are like to be very large, and asymmetric, leading to large current account imbalances.
- These flows of capital are likely to be very volatile, creating continuing demands upon the global system

- For example differential productivity shocks are likely to lead to movements in trade and capital flows of many percentage points of GDP between economies.
  - Preventing those capital flows, and thus preventing the significant movements in trade flows from emerging, is likely to reduce significantly the welfare gains that the productivity increases will make possible.
  - Preventing adjustments in the international trading system will also make it more difficult for other countries to benefit from the positive productivity shocks because the successful reallocation of capital around the world is an essential /part of the adjustment to these shocks.

- Enabling foreign investment to come into places where productivity is improving may well require reforms of the policies of governments and the policies of international financial institutions.
  - A number of these reforms have been described in other papers in this *OxREP* issue.
  - It is crucial that the necessary reforms necessary do take place.
- The demands on the international system are as large as those which were faced with initially setting up the Bretton Woods system
  - The task then was given to the World Bank.
  - Of course, the Marshall Plan played a crucial role alongside the role played by these two international financial institutions (IFIs).
  - Now—without a Marshall Plan—private financial markets will need to play a key role, alongside the IFIs, in making possible the necessary movements of international capital.

- The results for the demographic transition show that demographic-driven capital flows from more ageing to less ageing countries can be very substantial.
  - beneficial for young economies enabling them to finance productive investment and
  - favourable for ageing economies in enabling them to reap higher rates of return on capital than would be available domestically.
- The paper also describes Climate Transition Paths to 2050.
  - the very large resource flows to emerging market economies which will be needed to enable them to install zero-emissions capability, and
  - the risk to the global financial system of the risks of stranded assets as the world moves to zero emissions.
- Both of these things will present very great challenges to the global financial system

6 What next from this Panel?

- I will now pass the stage to Paola Subacchi who will take up the challenge that I have just announced. If the Financial System is to make possible these large current account deficits then it has to be both well-managed and well-led. Paola will talk about this .
- We then pass the stage to Chatib Basri and Jonathan Ostry.
  - For emerging market economies, there will need to be a way of managing the flows of financial capital to these countries,
  - This an important challenge, given that the above analysis suggests that these flows are likely to be large and volatile.
  - See for example recent Recent work by Hélène Rey and others which has suggested that *short-term* capital flows to developing countries may well be destabilising and so need to be more tightly regulated than at present.

- Furthermore, it is important to notice that the international system lacks an extensive, and satisfactory, safety net that provides countries with insurance against shocks and financing whilst adjustments are being carried out.
- In particular the Covid Shock has led to debt distress amongst a very large number of the worlds poorest countries and in emerging market economies.
- As a result of this debt distress, further debt relief for these countries may be required. An initial agreement along these lines agreed in 2021 – what has been called the “Common Framework”.
- More than this a sovereign debt reconstruction mechanism (SDRM) now seems to be an essential part of the global financial architecture.
- There are two important papers on this topic in this issue of OxREP. I am mentioning these now since neither Dede nor Jonathan will be talking about them.

The end