The International Monetary System

Maurice Obstfeld

University of California, Berkeley

Remarks at the International Monetary Fund Conference on "Macro and Growth Policies in the Wake of the Crisis"

Washington, D.C., March 7-8, 2011

Overture

- The crisis laid bare global stresses related to the two classic coordination problems the IMF was originally designed to address:

  -- Global liquidity needs

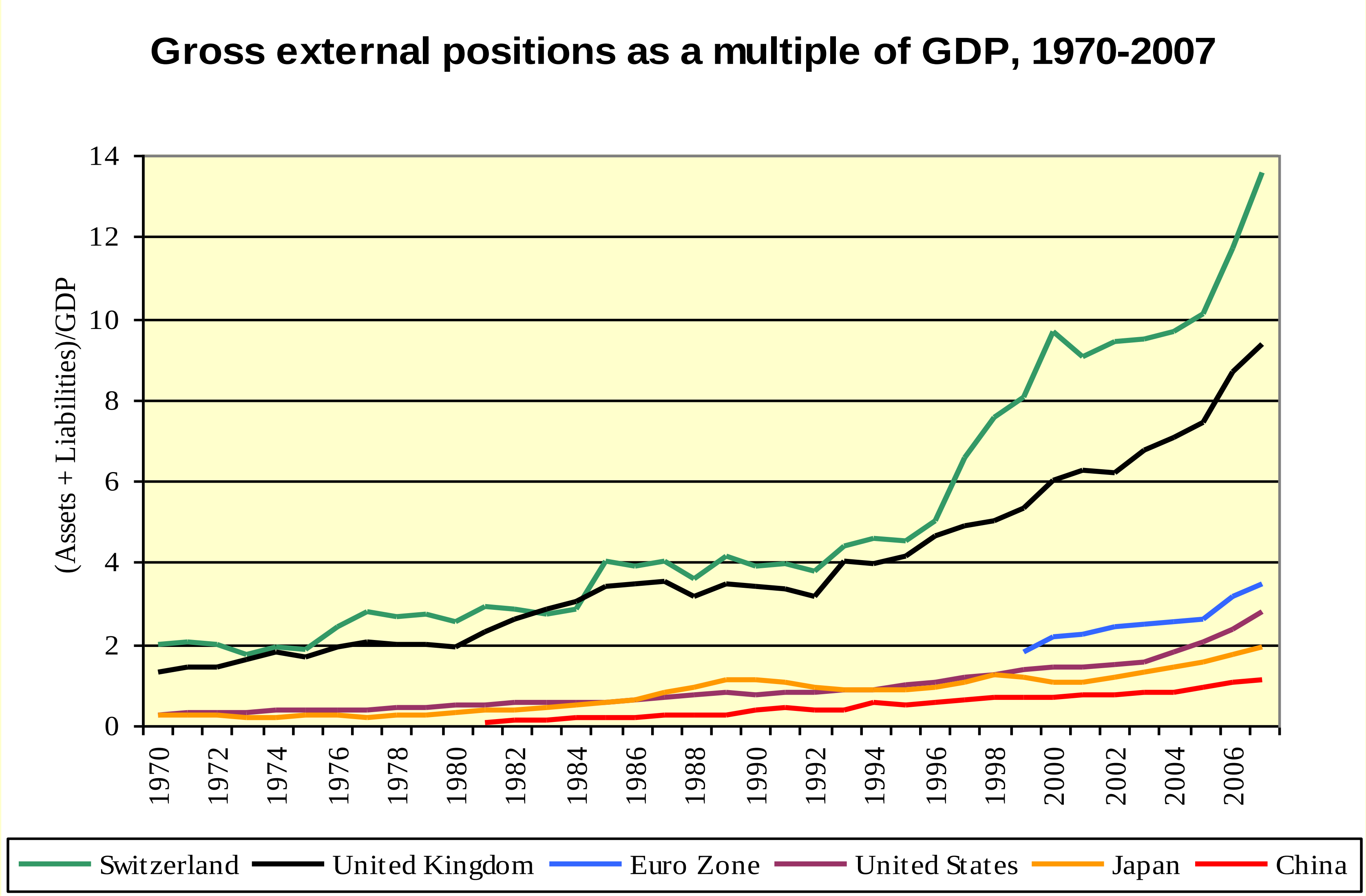
  -- Exchange rates and external imbalances

- Today's incarnations of these problems differ from those of the Bretton Woods era, pre-1973
- I will focus on ***liquidity*** today.

Financial Globalization a Major Change

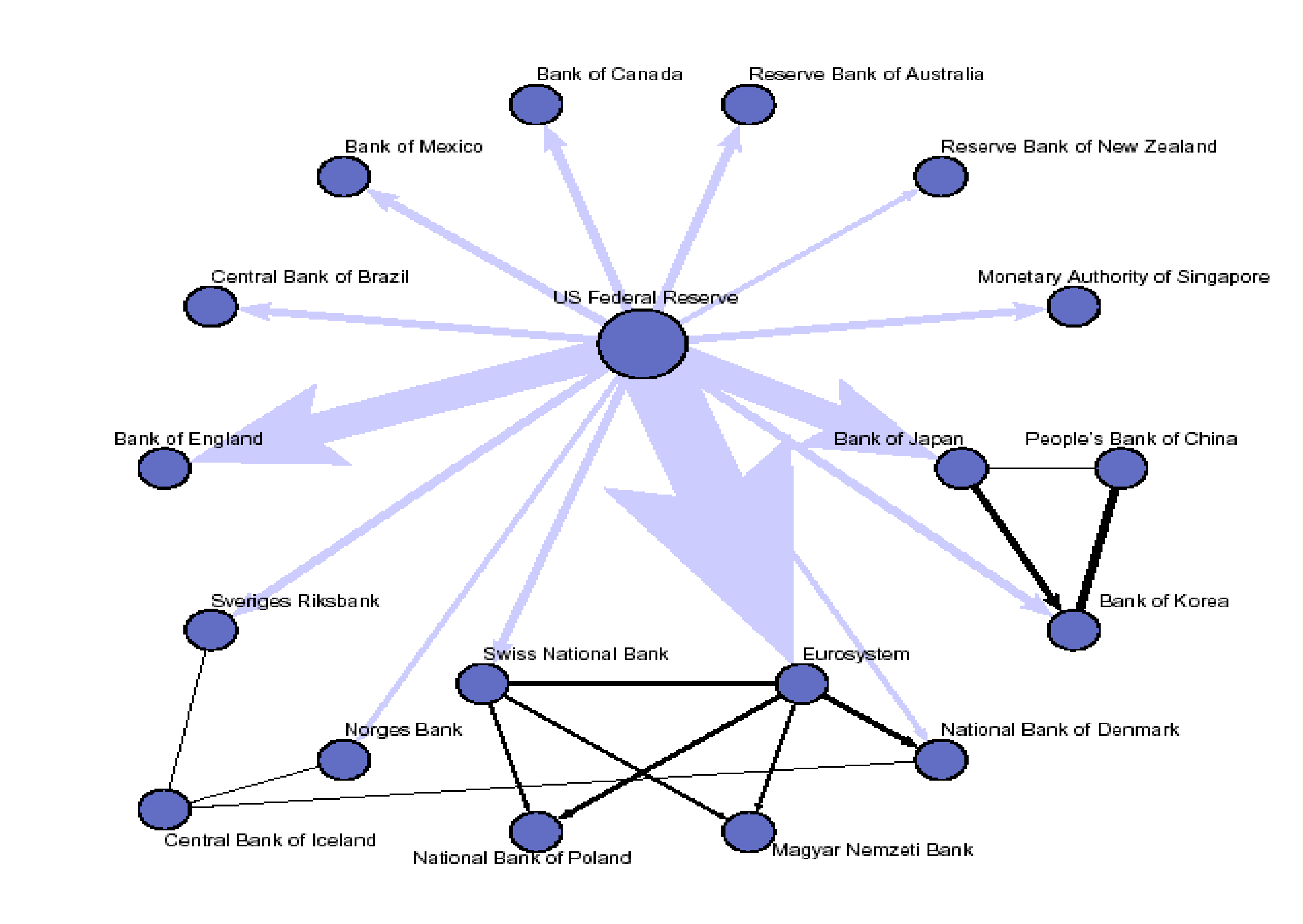
- There are benefits, but greater risks
- Inflated gross asset positions imply globally interdependent risks
- Risks of currency mismatch
- Financial risks, if socialized, become sovereign risks (Ireland and others)
- Ease of larger current account imbalances also carries risks (Greece and others)

Lane/Milesi-Ferretti on Gross Asset Positions



International Last-Resort Lenders

- Need for LLR support in ***multiple currencies*** to safeguard ***financial stability***
- Example: European banks holding dollar MBS
- This and similar problems led to 2007-2009 network of CB ***swap lines***
- Unlike Dillon-Roosa swaps of 1960s, not mainly for b. of p. support

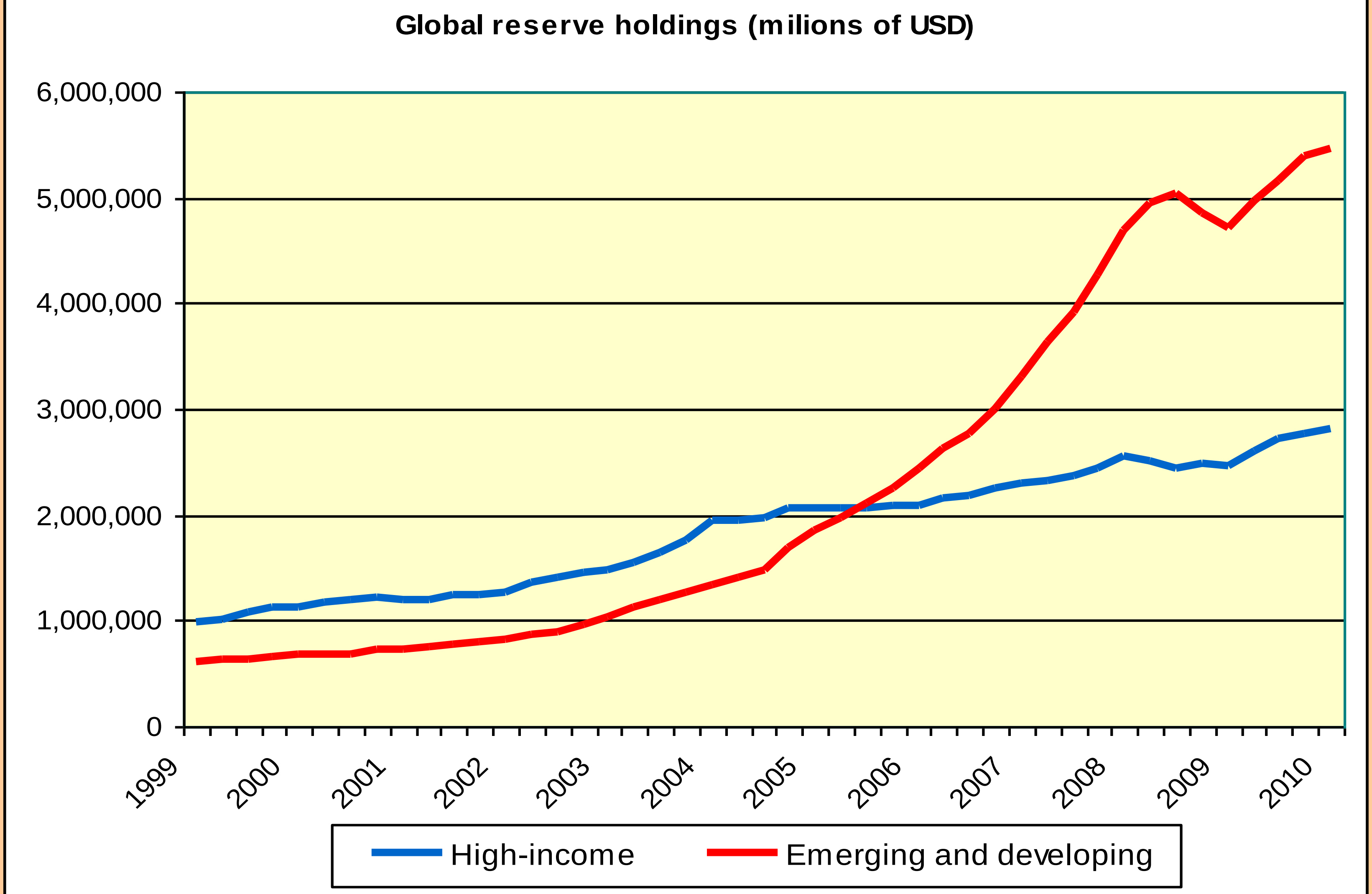


Source: Patrick McGuire and Goetz von Peter, "The US Dollar Shortage in Global Banking and the International Policy Response," BIS Working Papers No. 291, October 2009, at http://www.bis.org. Light arrows are USD, dark arrows other currencies. Arrows show direction of flow (if known).

Crisis Swap Network

- In the crisis, Fed became LLR ***for U.S. dollars*** to the world
- Will it be willing/able to maintain this ad hoc role indefinitely?
- Once, perceived creditworthiness of advanced countries made international LLR seem to be exclusively an EME problem
- Now?

Global Foreign Reserves



Source: IMF, COFER database

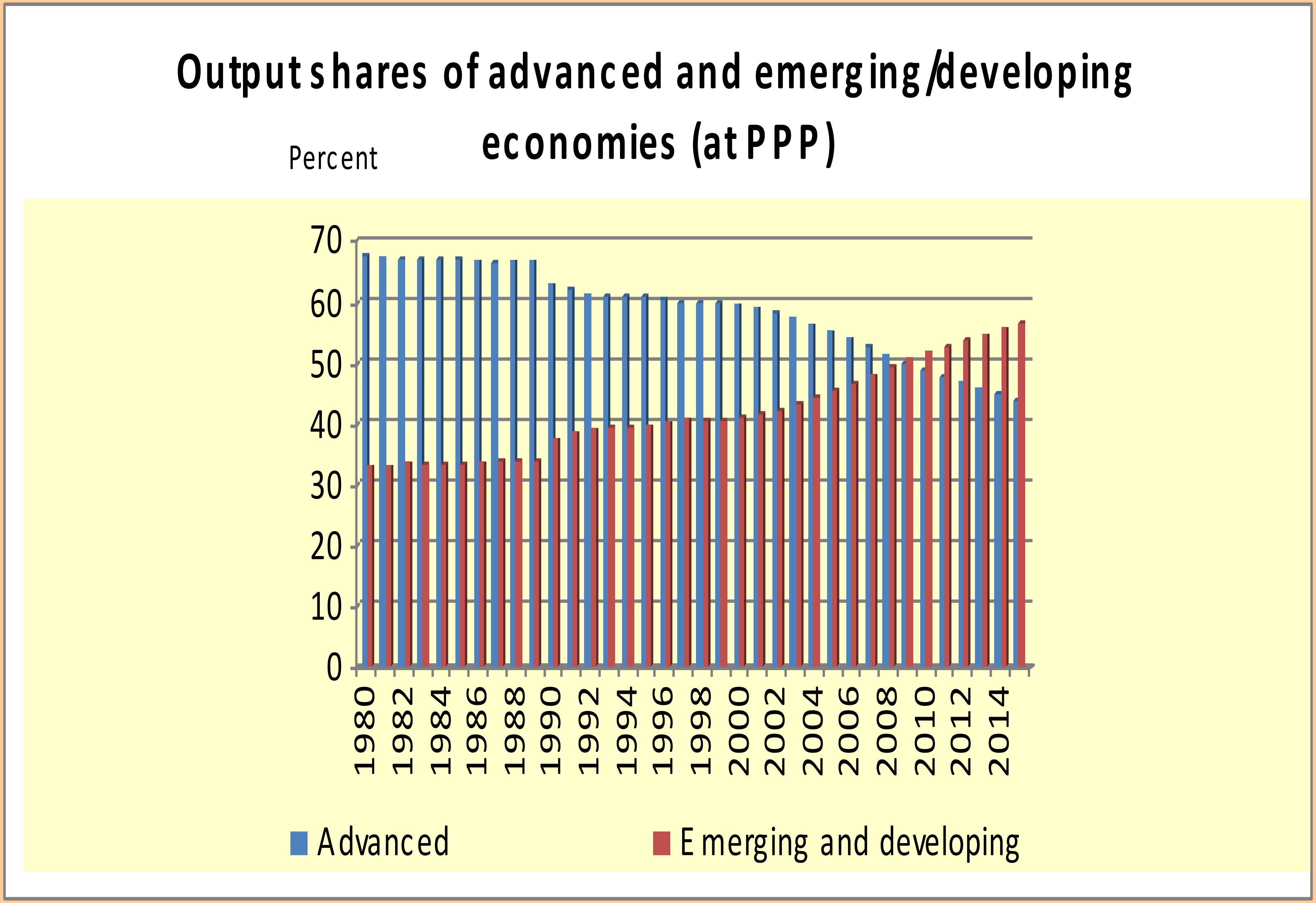
Systemic Problems from Self Insurance

- Reallocation of outside liquidity, not creation
- Asset-price effects (exchange, interest rates), especially as we near multiple reserve system
- Some reserves don't materially enhance financial stability
- My neighbor's reserves may decrease the utility of mine; fear of losing reserves
- Reserve accumulation ***may*** (but need not) be deflationary at the global level

Another Systemic Threat: Reserve Adequacy

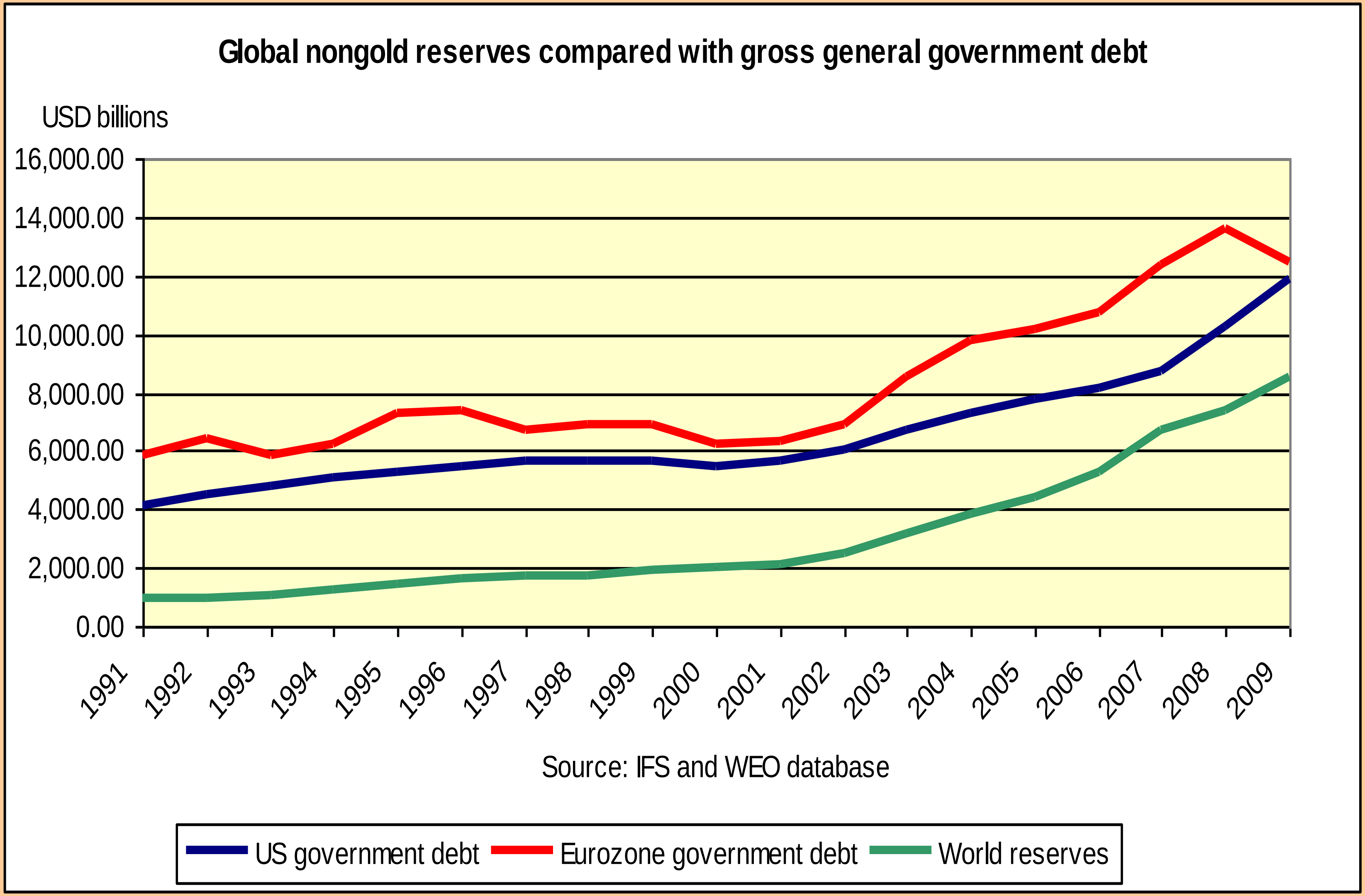
- There is a modern-day ***Triffin paradox***
- Clear recent statement by Farhi, Gourinchas, Rey, "Quelle reforme pour le systeme monetaire internationale?" (January 2011)
- If reserve demanders prefer safe government debt (they may not), gross debt may have to rise beyond fiscally prudent levels – making it risky!
- "Internal contradiction" is due to asymmetries in economic growth rates, creditworthiness

EM/Developing Economies in World GDP



Source: WEO database, October 2010; projections after 2009

International Reserves versus Public Debts



Better Ways of Meeting Liquidity Needs

- Expanded Fund resources, flexibility to meet the needs of governments in crises (FCL, PCL)
- How to make these attractive relative to reserves?
- Codify central bank swaps, perhaps run through IMF directly to qualifying central banks – relation to direct loans to the sovereign?
- Requires higher surveillance of financial stability, in part as a brake on moral hazard
- SDRs function much like claims on a reserve pool, which is useful, but does not create outside liquidity

Meeting Liquidity Needs (cont’d)

- Outright reserve pooling superior to transactions involving SDRs and currency transformation
- Credit lines in multiple currencies diminish dollar’s singular role as reserve currency (but ***not*** as vehicle currency, where it is by far dominant)
- ***Liquidity vs. solvency:*** Need to promote orderly sovereign debt resolution procedures
- A larger scale of IMF operations raises in a major way the issue of ***fiscal backup*** by member governments – much as in the European context

Deeper Moral of All This…

- What is the main challenge at the regional (e.g., eurozone) and global levels?

  National sovereignty and self-interest – as expressed through democratic political processes – are not inherently friendly to globalization.

  To support the expanded globalization of markets, the globalization of governance institutions must expand as well.