

# **The International Monetary System in the Last (and Next) 20 years**

by

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## **Comments**

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# A great roadmap to facts and policies options

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## **What is the future of the international monetary system (IMS)?**

### **The paper discusses at length the “bipolar view”**

- **Emerged from the experience of the 1990s**
  - **The idea that rising capital mobility would force countries to abandon exchange rate regimes characterized by intermediate steps of exchange rate flexibility.**
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- **To what extent does the “bipolar view” have predictive power?**
    - **I find it useful to summarize (heroically) the (counter-) arguments by the authors in 6 theses**

# 6 theses on the past and future of the IMS

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## **1. The bipolar view applies to developed countries, not to emerging markets and developing countries.**

- In the first group, the bipolar view mostly reflects the introduction of the Euro**
- Conditioning on the past 20 years, the authors estimates a Markov chain model of regime transitions. Over the next 30 years, the model predicts:**
  - 8 a modest overall decline in the share of intermediate exchange rate regimes for the world as a whole.**
  - 8 a falling share of floating regimes among the emerging markets.**
  - 8 More hard pegs among developing countries**

## 6 theses

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### **1. (cont.ed) On the capital mobility side of the bipolar view:**

- The group of developed countries have moved to full liberalization of capital account**
- Among emerging markets and developing economy, progress are slow.**

## 6 theses

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**2. Capital mobility is a pre-requisite to exchange rate flexibility as firms and banks need financial instruments to deal with volatility in international prices.**

- But capital account liberalization is possible only after institutional, legal and macroeconomic reforms to strengthen financial markets and intermediaries**
- a floating regime is precluded to countries that have not completed such reforms**
- The road towards exchange rate flexibility is parallel to the road towards successful deregulation and liberalization of capital markets**

## 6 theses

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**3. Hard pegs are not viable for emerging markets because (a) regional monetary unions are precluded (b) unilateral peg forces country to loose controls over monetary policy (c) unilateral peg lacks political commitment.**

## 6 theses

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- 4. The international currency status of the dollar will lose some ground because of the euro and perhaps other currencies, but “tipping point” scenarios are unlikely**
- Historically, the coexistence of different currencies with international status was the norm in the gold standard.**
  - Proliferation of financial instrument minimizes currency-specific transaction costs. This undermines the strength of a key assumption in the argument predicting shifts from one currency standard to another (stressing network externalities).**
  - No King-Kong vs Godzilla**

## 6 theses

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- 5. The real test of the stability of the euro area can only be a major financial crisis (say, in the form of a run on the public debt of a country), forcing the ECB to choose between**
- a tough stance (to teach the fiscally irresponsible government a lesson), which would imply 'neglecting the goal of financial stability'**
  - a loose stance (to prevent financial contagion via abundant injection of liquidity) which would (a) compromise the goal of price stability and (b) imply fiscal redistribution.**

**A political crisis is bound to follow, challenging "the wisdom of leaving such an important decision in the hands of anonymous technocrats"**



## 6 theses

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### **6.China needs to move towards greater exchange rate flexibility**

- not to engineer a re-valuation of the renminbi (currently, a 15 percent appreciation would wipe out profits of Chinese exporters, who rely heavily on imports, and have low productivity)**
- but to gain control of aggregate demand via monetary policy (as capital controls cannot provide the market segmentation required to pursue both internal and external objectives).**

...and a few notable absences

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## **Times have changed!**

- **IMF**
- **Policy coordination**
- **Is exchange rate flexibility desirable?**
- **Yen**
- **...**

...and a few notable absences

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