Bretton Woods @ 70: Regaining Control of the International Monetary System

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Ladies and Gentlemen,
I am very pleased to welcome you to the conference on "Bretton Woods @ 70 – Regaining Control of the International Monetary System", which is hosted jointly by the Reinventing Bretton Woods Committee, the Austrian Federal Ministry of Finance and by the Oesterreichische Nationalbank.

I am particularly delighted that we have managed to attract so many distinguished speakers from around the globe, among them academics, market participants, as well as policymakers. You are all here in Vienna today to discuss with us, from different angles, the evolution of the international financial system, both in a historical and in a forward-looking perspective. Let me thank in advance to all our speakers for their contributions. I feel also honored that such a great number of participants have accepted our invitation to attend.

Our conference will be organised in six sessions. We will start out with a historical account of the role of the Bretton Woods system, including the Bretton Woods institutions, namely the International Monetary Fund (IMF) and the World Bank. Subsequently, session two will be devoted to the euro area's role in the international monetary system. The creation of the euro in 1999 was one of the biggest changes in the international monetary system since the breakdown of the Bretton Woods system in the early 1970s. Session three will take up the issue of global adjustment in an increasingly multipolar world. Session four will deal with the management of capital flows, reserves and exchange rate volatility, which is a topical issue given the current problems in some emerging economies. Session five will cover the topic of preventing the middle income trap. Session six shall draw conclusions and provide an outlook on the possible future role of the international monetary system and the lessons learned from the Bretton Woods System.

From the 60th to the 70th Anniversary: Taking Stock of the Past Decade

Almost exactly ten years ago, in June 2004, we held a conference here in Vienna, at that time to commemorate the 60th anniversary of the Bretton Woods institutions – some of you have joined us already at this conference.

I would like to use this opportunity and take stock of these past ten years, which have indeed been an interesting and equally challenging period, both for Europe and for the global community.

In spring 2004, the European Union had just been joined by ten new Member States. Since then, the EU has undergone two further enlargements, with the entry of Bulgaria and Romania in 2007 and of Croatia in July 2013, so that it now comprises 28 Member States.

Over the same ten years, the euro area of – then – twelve members (in 2004) has grown to eighteen participating countries and constitutes a milestone in the European integration process. The euro is a fully functional and internationally traded currency, which shields its individual Member States from speculative currency attacks. From its start, the euro has been the second most important international currency after the US-dollar. Despite the increasingly difficult environment in recent years, the relatively strong role of the euro on the global stage has remained broadly unchanged, with the euro's share in global foreign exchange reserves standing at around 24% at the end of 2012.

The year 2008, however, has marked a turnaround for the global economy. The US financial market turmoil of fall 2008 subsequently triggered the most severe economic crisis since the Great Depression of the 1930s. While the Bretton Woods institutions had to deal with a continuous series of financial crises over the previous decades, such as the Mexican or the East Asian financial crisis or the Russian debt default in 1998, this recent wave of crises was different insofar as it affected, for the first time, mainly advanced economies. Consequently, its effects were of a different magnitude and much more severe as compared to previous crises, and they are still lingering. While both the USA and the euro area underwent a period of stagnation in 2008 and, subsequently, a strong recession in 2009, the euro area was hit even stronger than the USA, with weaker growth in the following years and the emergence of banking and sovereign debt crises in several EU Member States from 2010 onward.

Dealing with the Crisis – A Joint Endeavour by the IMF and Europe

While the IMF, as most other institutions, was caught more or less by surprise by the outbreak of the current crisis, as well as by its severeness and its persistence,

the crisis was weathered relatively well so far. This was accomplished thanks to an unprecedented spirit of cooperation and support, which we have witnessed since the beginning of the current crisis on the global level.

Already in April 2009, in response to the breakdown of international financial markets, the international community agreed to massively increase IMF resources to a total of USD 750 billion, with substantial worldwide contributions. Already in March 2009, the EU quadrupled its balance of payments support funds for non-euro area EU Member States to EUR 50 billion and the EU committed another EUR 75 billion (approx. USD 100 billion) in the form of bilateral loans to the IMF in order to support its lending capacity. This prompt increase of global and European firewalls constituted important stabilizing steps at this very early stage of the crisis, which were particularly important for Central, Eastern and Southeastern Europe (CESEE).

In a similar vein, the so-called "Vienna Initiative" had been launched already in January 2009 in order to create a framework for safeguarding the financial stability in CESEE. The „Vienna Initiative" served as a forum for major international financial institutions, among them the IMF and the World Bank, the most important European institutions, home and host country regulatory and fiscal authorities and the largest banking groups operating in the region. The „Vienna Initiative" helped to avoid a potentially region-wide systemic crisis in the CESEE banking sector.

In the following years, as the crisis had not abated, European firewalls for the euro area members, the ESFS and its permanent successor institution, the ESM, were established and their firepower was substantially increased in order to address the challenges arising from the banking and sovereign debt crises. Furthermore, in December 2011 the euro area and other EU Member States committed additional bilateral loans to the IMF of up to EUR 200 billion (USD 270 billion), thus strengthening once more the IMF's firepower.

Global cooperation even went one step further and got a new political and institutional dimension. For the first time in history, the IMF and the EU jointly entered into macroeconomic adjustment programs for individual EU Member States. This implied that consistent and mutually agreed decisions had to be taken on the respective program financing, the initial program design including macroeconomic conditionalities as well as on program surveillance. This close cooperation between the IMF and the EU, which has posed numerous challenges for both sides, has proven mutually beneficial; in particular also due to the IMF's longstanding expertise in macroeconomic programs as well as its well-established international credibility.

From 2009 to 2011, several EU Member States outside the euro area, such as Latvia, Hungary and Romania, were the first beneficiaries of such joint IMF-EU programs. From spring 2010 on, Greece was the first Member State within the euro area, which received a financial assistance package negotiated by the IMF and the

EU. By December 2010 and May 2011, respectively, Ireland and Portugal followed, and in May 2013 Cyprus was provided financial support.

This vast support of comparatively wealthy, advanced economies did not remain without criticism in the international debate. Notwithstanding, the unprecedented order of magnitude of some of these financing packages, I am convinced that it was the right approach that the IMF stood ready to provide financial support to its members, in these exceptional times, as need arose. As regards the issue of international burden sharing, I would like to emphasize that, as a rule, at least two thirds of the total financing for euro area Member States are provided by the EU itself. In addition to this direct involvement in program financing, the EU provides a substantial part of the IMF's share in program financing, via its contribution to IMF resources.

Challenges ahead: Designing Exit Strategies for Program Countries, Reforming the IMF's Governance, Preventing Future Crises

Looking at the challenges ahead of us, I am convinced that the IMF should continue to strive that program countries regain access to market financing as soon as possible in order to prevent a prolonged use of Fund resources. Ireland's successful graduation from its program a few months ago can certainly be seen as a positive example in this context. In a similar vein, sustainable exit strategies have to be defined also for other program countries over the next years, as well as for those which are benefitting from precautionary arrangements.

In view of the increasing economic importance of emerging economies, we support the IMFs governance reform which aims at increasing the representation of emerging market countries in the IMF Executive Board at the expense of advanced European countries. In this context, I would like to recall that in July 2012, Austria, together with other Central and Eastern European countries and with Turkey, established a new IMF constituency, thus contributing to achieve the aforementioned aim of the IMF's governance reform. This marks a historic milestone as it will place the dynamic Central and Eastern European region, in rotation with Turkey, directly on the map of the IMF's Executive Board.

Finally, in recent years it has become clear that the deregulation of financial markets has reached its limitations and that deregulated financial markets tend to be instable and are likely to trigger financial crises. The IMF (Laeven, Valencia, 2012) finds that over the period 1970 to 2011 the world's economies were confronted with a total of 218 currency crises, 66 sovereign debt crises and 147 banking crises. The authors show that dealing with crises causes high economic costs. They find cumulative output losses of 32.9% of GDP in advanced economies originating from banking crises, an increase in public debt levels by another 21.4 % of GDP and

cumulated fiscal costs (i.e. fiscal outlays directed to the restructuring of the financial sector) in the order of 3.8% of GDP. Given these enormous costs related to banking crises, there seems to be a change of paradigm since the beginning of the current crisis in 2008, with a tendency to return to increase the degree of financial regulation and with a more active use of fiscal policies in order to counteract or avoid banking crises in advanced economies.

While the euro area Member States were protected against currency crisis by their common currency throughout the current crisis, as mentioned earlier, some EU Member States were, however, affected by banking and subsequently sovereign debt crises. In response to these developments, the EU has substantially strengthened its economic and fiscal governance over the past years, with the enhanced Stability and Growth Pact and the newly created Macroeconomic Imbalances Procedure. Furthermore, with the aim to prevent banking crisis for the future, the EU is currently preparing to establish a Banking Union, which will comprise the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM). I am confident that the completion of the Banking Union will contribute to break the negative feedback cycle between sovereign and banking-sector problems.

Concluding Remarks

The continuing global economic turmoil underscores the importance of the Fund as a forum for multinational dialogue as well as of its financing capacity also for the coming years.

The unprecedented joint crisis management, undertaken by the IMF together with Europe, over the past few years has served the common goal of stabilizing the European economy which helped to stabilize the world economy. Moreover, this cooperation between the IMF and Europe can possibly be seen as a blueprint for future cooperation between the Fund and regional financial arrangements.

Looking ahead, the IMF's longstanding surveillance function should remain at the core of its activities and will have to be even further developed. Given the increasing inter-connectedness of economies in the world, the Fund's policy advice on how to address policy spillovers needs to be systematically included into bilateral surveillance. Furthermore, we welcome the Fund's increased efforts to strengthen its surveillance of financial sectors. In particular, even more emphasis will have to be put on spillover effects from national prudential measures, in order to prevent increased financial fragmentation originating from inconsistencies across national jurisdictions.

Our goal should be to reform the international monetary system so that it is less crisis-prone in future. The Bretton Woods system has been very successful in avoiding financial crises and achieving high growth rates from 1945 to 1970.

I hope this conference can provide us with advice and examples how to reach this goal – a stable international monetary system, conducive to growth.

To conclude, I am looking forward to a fruitful and stimulating exchange of views during this conference and I wish you all an interesting stay here in Vienna.