Bretton Woods and the IMS in a Multipolar World?

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Very few international conferences have produced such a consequential outcome as the Bretton Woods Conference, which took place at the Bretton Woods hotel in New Hampshire 70 years ago. This international conference, which was held in July 1944, created the twin organizations – the International Monetary Fund and the World Bank. It also laid the foundations to what was to become the international monetary system of the post-World War II era. The Oesterreichische Nationalbank under the leadership of Governor Ewald Nowotny, together with the Federal Ministry of Finance of Austria represented by State Secretary Jochen Danninger and Mr. Marc Uzan, Executive Director of The Reinventing Bretton Woods Committee, deserve our thanks and appreciation for putting together such an impressive conference that puts into perspective key issues in the International Monetary System.

Previous speakers on this panel provided very useful insights based on their own reminiscences of their long careers and experience as participants and observers of the international monetary system; in my contribution to the panel I will do the same.

Thirty years ago, in 1984, the Federal Reserve Bank of Boston convened a conference to commemorate what was then the 40th anniversary of Bretton Woods. In order to get a flavor of the time, I looked up the proceedings of that conference and the following were the participants: Edward M. Bernstein, who was a member of the American delegation to the original Bretton Woods Conference and served as a close advisor to Harry White, the head of the delegation; Eddie Bernstein was subsequently appointed as the first research director of the IMF; Jacques J. Polak, who was also at the original Bretton Woods Conference as part of the Dutch delegation and subsequently succeeded Eddie Bernstein as the research director of the IMF, Lord Eric Roll, Ariel Buira, Anthony M. Solomon, John Williamson, W. Max Corden, Pedro-Pablo Kuczynski, Charles P Kindleberger, Robert V. Roosa, Robert Triffin, Robert Solomon, Henry C. Wallich, Robert Z. Aliber, Otmar Emminger, Rudiger Dornbusch, Adolfo C. Diz, Eduardo Wiesner, and C. Fred Bergsten. These individuals were among the key players of the time. The 1984 Boston Fed Conference also included two additional "young participants" who happen to also take part in the present conference as panelists in today's session: Richard N. Cooper and myself.

There is a consensus that the original Bretton Woods Conference, which was held over an intense period of three weeks, was a success. In terms of an organization of such a policy conference there is still the question of whether it was a success due to or in spite of its concentrated duration and intensity. According to Eddie Bernstein's account, the success was due to very thorough preparatory work. The technical analysis that preceded the final conference lasted for about two and a half years, which culminated in the final three weeks long conference. According to Bernstein, without such a detailed preparation the outcome would not have been the same. Some of the subsequent commentators emphasized the collegiality and almost friendship that allegedly characterized the relationships among the participants. In fact, however, there was a lot of tension and that tension was visible from the body language exhibited in some of the photos as well as from informal accounts and descriptions of those present. Such tensions were not just present among the separate delegations but also between delegates who belonged to the same delegation. When Harry Dexter White, who led the American delegation, presented his proposal, some of his colleagues thought that it was much too ambitious; at the same time others, like Jacob Viner, who was a prominent professor, criticized it as being too timid (he described it as preparing an umbrella when a bomb shelter had to be prepared).

The proposals themselves revealed some ambiguities in drafting. Some scholars examined these ambiguities and attributed them to haste. However, as noted by Eddie Bernstein, Louis Rasminsky, the Chairman of the drafting committee, who subsequently became the third Governor of the central bank of Canada, explained that there were no unintentional ambiguities in the Fund Agreement. What seemed to be ambiguities was the result of skillful drafting aimed at universal approval rather than sloppiness and haste. The necessity to bridge disagreements also created tensions, stress and criticism. As an illustration, I recall that towards the end of the conference, John Maynard Keynes, who was the head of the British delegation, stated in his concluding speech "I am greatly encouraged, I confess, by the critical, skeptical and even carping spirit in which our proceedings have been watched and welcomed in the outside world. How much better that our projects should *begin* in disillusion than they should *end* in it". It is alleged that by the end of the conference Keynes was very frustrated with the legalistic details that the various lawyers were putting in as obstacles. Indeed, it is said that when he thanked the various contributors to the proceedings he looked at the lawyers and quipped in frustration: "if it was up to the lawyers, they would have declared common sense to be illegal". So much for collegiality and good atmosphere.

One of the key features of the international monetary system that was constructed at the original Bretton Woods Conference was the recognition that the world economy is interconnected. This interconnectedness manifested itself through international trade, through capital movements, and through exchange rates. The interconnectedness necessitated the adoption of agreed rules and required some form of international policy coordination. Carrying on with my personal reminiscences, this brings me to recall my own involvement in the policy coordination process. In 1986, while I was the David Rockefeller Professor of International Economics at the University of Chicago, I received an invitation from Jacques de Larosière, who at the time was the Managing Director of the IMF (we are privileged to have him present here today as the chairman of this panel). Mr. de Larosière invited me to come from Chicago to Washington, D.C., in order to "discuss current international policy matters", when I came to his office, I recall noting that behind his desk there was a beautiful bust of John Maynard Keynes. Being an academic from the University of Chicago, I was very curious to know what was this bust doing at the office of the Managing Director of the IMF. Mr. de Larosière explained to me that following the original Bretton Woods Conference of 1944, two busts were presented to the IMF as special mementos; one was of John Maynard Keynes, the head of the British Delegation and other was of Harry Dexter White, the head of the American Delegation. He explained to me that he decided to keep John Maynard Keynes' bust in his own office and place the bust of Harry Dexter White in the office of the Deputy Managing Director of the IMF. With this historical anecdote we moved on to discuss some of the characteristics of Keynesian economics, and I recall that this was an extraordinary, stimulating and completely unexpected insightful conversation. Of course, this was not the reason for which I was summoned to the IMF. As the conversation proceeded, the Managing Director went on to describe to me the structure of what was then the framework of international policy coordination. He told me that the G5 (Group of Industrial Countries – the US, Japan, Germany, France and the UK), have decided under the prodding of James Baker, the Secretary of the Treasury of the United States, to enhance their policy coordination framework, and that they have invited the IMF to serve as the secretariat of the process. In this context, Mr. de Larosière invited me to become the Economic Counselor and Director of Research of the IMF. My responsibility included the production of the World Economic Outlook of the IMF and to be involved in the G5 policy coordination exercise. Mr. de Larosière expected a quick response to his offer and reminded me that if I accept, I will become the fourth Economic Counselor and Head of Research in the history of the IMF and as such would follow the distinguished list of predecessors, Eddie Bernstein, Jacques Polak (both of whom attended the original Bretton Woods Conference), and William Hood, a former government minister from Canada. Obviously, one never says no to Jacques, and I accepted his offer. This marked for me the beginning of a wonderful multi-decade friendship. During his distinguished tenure as Managing Director of the IMF, Jacques de Larosière served as a role model. He demonstrated skillfully how one could run the IMF with both diplomacy and spine, and those two do not always go easily together unless they are anchored in deep professional convictions. Jacques de Larosière demonstrated that the two could go together.

My first meeting with the G-5 deputies for the discussion of international policy coordination was an eye-opener. It revealed dramatically the difference between the nature of debate in academia and the nature of debate with policymakers who represent their respective countries. The first topic of discussion was the international consequences of budget deficits. I described in detail how excessively large budget deficits are bad, how sustained deficits increase government debt, which ultimately harms economic growth. To my dismay, the deputy from a major country argued that budget deficits do not really matter and that as a result their international impacts are negligible; it was a rude awakening. I realized quickly that what was self-evident in my academic training was subject to political judgments in policymaking circles. We went on to discuss the negative international consequences of current account imbalances and again I found out that "where you stand depends on where you sit"; namely, countries with large current account deficits insisted that the imbalance be corrected through a rise in spending in the surplus countries abroad; by the same token the countries with the large surpluses expected the adjustment to take place by the deficit countries, which were expected to cut their spending relative to their income. In short, the debate was about who should initiate the adjustment. This debate highlighted the challenges that international policy coordination faces. The deficit countries wish that the adjustment takes place by the surplus countries while at the same time the surplus countries wish that the adjustment takes place by the deficit countries. The fierce debate was about the question of who should act and what actions need to be taken. With the passage of time the debate on policy coordination was summarized by 5Ws and 1H. The 5Ws are: Why should countries coordinate? Who should coordinate? When should policy be coordinated? Where should policy be coordinated? What policies should be coordinated? The H is: How should coordination be implemented? These issues, which were central to the design and implementation of the policy coordination exercise, were the focus of discussion leading to the G-7 Louvre Agreement of 1987. It represented significant progress from the framework which underlined the previous policy coordination exercise that culminated in the Plaza Agreement of 1985. While the Plaza Agreement focused on international exchange rate adjustments, the Louvre Agreement focused on internationally coordinated macroeconomic policies. The shift from the narrow focus on exchange rates towards a broader focus on the wide range of macroeconomic policies, represented analytical progress but at the same time it revealed a fundamental political reality. In modern democracies, policymakers represent and are accountable to their own national constituencies and no individual country can expect to be able to decide what should be the policies undertaken by other countries. Hence, very quickly it became apparent that the concept of policy *coordination* should be replaced by the concept of policy *cooperation,* the idea being that the policy cooperation framework focuses on the exchange of information that improves the understanding as to how different economies work, how the decision-making process is implemented, the meaning of the various data that are presented by each country and the considerations that underlie national priorities and preferences. This is probably the most that international cooperation can bring about in the interdependent world while recognizing and respecting different national characters, histories, backgrounds, and objectives. Yet, the interdependent world as a whole is well served by having the modest mechanism of policy cooperation that is instrumental in facilitating outcomes that internalize some of the externalities that prevail in the complex interdependent world.

When we completed the discussion on international policy cooperation, I suggested that we move on to discuss exchange rate arrangements among the major currencies. This was the period before the introduction of the euro and therefore there was a large number of bilateral exchange rates that had to be considered among the G-7, and of course since not all of the bilateral exchange rates are independent of each other, consistency had to be assured. Here came my second big surprise: I noted that around the table of the G-7 deputies there was not a single representative of a national central bank. Only representatives of the respective national ministries of finance were present. This was obviously an aberration that made no sense although it reflected the political reality and the relative positions of the national central banks in the power play within the respective economies. Fortunately, with the passage of time this distortion was corrected and the central banks were invited into the room.

The role of the Fund was also evolving. My first assignment as Economic Counselor and Director of Research of the IMF was to prepare a paper for the Executive Board titled "The Role of the Fund". Initially I was somewhat surprised as I thought that after more than four decades since the creation of the IMF its role would be well defined. It was explained to me however, that each year the executive board needs to re-examine the role of the Fund since circumstances change, new challenges come up, new approaches need to be developed, new instruments need to be designed and the Fund must develop its intellectual arsenal so as to stand ready to meet new challenges. With the benefit of hindsight it is obvious that this was the correct approach and indeed as one observes the challenges that have faced the International Monetary System and with it the Bretton Woods Institutions, it is obvious that a lot of changes have taken place. It is noteworthy, however, that while the financial needs of the Fund grew vastly, and indeed the international commitments to increase the size of the capital of the Fund was also announced, the political appetite needed for the implementation of such an increase in the size of the Fund is still lacking.

Over the years, the world economy has witnessed a growing degree of interdependence and this is especially the case since the rapid growth of international capital markets. These developments gave rise to various proposals for reform of the international monetary system, including very complex proposals. This is not the occasion to provide a detailed analysis of some of these proposals. However, it is relevant to note that an operational international system must be practical, transparent, clear, and relatively simple. In this regard, it is worth recalling Albert Einstein's dictum according to which: "to each problem one should always try to find the simplest solution, but avoid solutions that are simpler than that."

Is the system ready to face the main challenges in the global economy of today? In what follows, I outline briefly key challenges that remain.

1. The global economy has witnessed a dramatic shock in the recent financial crisis. As a result, the level of world output declined in 2009 as growth was negative. Practically all of the industrial countries went into recession and, in contrast to past crises, the developing countries, especially in Asia, have shown greater resilience. The question is whether the system has learned how to prevent such a cataclysmic event in the future?
2. Also owing to the sustained economic growth of the past decades, the volume of international trade has also expanded every year. A major exception was 2009 in which the volume of trade actually shrank by more than 10%. This decline in the volume of international trade caused a further aggravation of the financial crisis. The question is whether the system has developed sufficient mechanisms to prevent a repeat of such a development?
3. After many years of debate concerning the size of external imbalances of different countries, such imbalances still prevail among the major economic blocs and also within an economic bloc such as Europe. The question is whether the system can develop operational mechanisms that will prevent the emergence of large and sustainable external imbalances before such imbalances create dangerous vulnerabilities to the system.
4. The center of gravity of economic power has shifted dramatically during the past 20 years from industrials countries to developing countries, especially in Asia. For example, while in 1990 sixty-three percent of the world output was produced in the U.S., Europe, and Japan, today the same industrial countries produce only forty-five percent of world output. Industrial countries' declining share was made up for by developing countries' rising share. For example, whereas in 1990 China and India together produced only seven percent of world output, today these countries produce more than twenty percent of world output; these are huge changes in a historical perspective. The question is whether the international monetary system is capable of adjusting so as to reflect the new structure of the

world economy. Specifically, are the industrial countries willing to forego part of their IMF quota share in favor of the developing countries? By the same token, are the developing countries able and willing to play a larger role in the international monetary system commensurate with their growing economic size?

5. Most central banks in the world have lowered their interest rates to levels close to zero. These low levels are below what is sustainable and desirable for the medium term. At the same time many central banks continued to inject liquidity to the system through the adoption of "quantitative easing" and unconventional monetary policies. The question is whether the process by which normalization is restored and interest rates are raised will be orderly. In particular, are the balance sheets of financial institutions sufficiently robust so as to withstand the challenges arising from higher rates of interest?
6. The creation of the eurozone provided the opportunity for great improvement of Europe's economic performance. However, it resulted in great structural imbalances within Europe. The question is whether European policymakers are able to reduce such structural imbalances so as to lower the rate of unemployment and reduce the gap among the various eurozone countries in both labor market conditions as well as competiveness and productivity?
7. Demographic trends all over the world pose serious challenges. In many countries, the population is aging and in some countries the size of the population is shrinking. Such trends pose significant challenges to social security systems, to pension systems, to fiscal management and the like. The question is whether the international monetary and financial system can develop satisfactory approaches to deal with such medium term challenges?

Hopefully, in the future when we commemorate the 80th anniversary of the Bretton Woods conference, we will have found positive solutions to some (and may be all) of these challenges.