

Ocampo Gaviria, José Antonio

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WIDER Working Paper 2016/49

Global macroeconomic cooperation and the exchange rate system

José Antonio Ocampo*

April 2016

Abstract: This paper looks at historical and current frameworks to manage macroeconomic linkages among economies. It considers first the evolving nature of global payments imbalances. It then focuses on the mechanisms of macroeconomic dialogue and cooperation put in place at different times to guarantee the consistency of the macroeconomic policies of major economies. These mechanisms have operated sometimes within the International Monetary Fund, but generally outside its institutional framework, and in recent years through the Group of Twenty. Finally, it analyses the functioning of the original Bretton Woods exchange rate system and its replacement in the early 1970s by a veritable ‘non-system’.

Keywords: global imbalances, macroeconomic policy co-ordination, exchange rate system, International Monetary Fund, Group of Twenty

JEL classification: F32, F33, F42

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* School of International and Public Affairs; Committee on Global Thought; and Initiative for Policy Dialogue, Columbia University; ocampo.joseantonio@yahoo.com.

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Katajanokanlaituri 6 B, 00160 Helsinki, Finland

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1 Introduction

The recent North Atlantic financial crisis¹ placed world macroeconomic and financial stability at the centre of the global agenda. The first objective of cooperation in this area may be understood as guaranteeing an adequate supply of liquidity at the international level and the global coherence of macroeconomic policies, particular those of major countries. A second objective calls for a coherent set of regulations that helps prevent financial crises as well as instruments to manage crises when they occur.

The need to strengthen financial regulation and supervision has been a clear priority in recent years. Under the co-ordination of the Financial Stability Board (FSB), re-regulation of finance has been going on at an unprecedented scale in the industrial world, although plagued by delays in implementation, insufficient co-ordination, and political economy pressures to weaken the reform efforts. The emerging economies underwent similar processes after their own financial crises, which was no doubt one of the reasons why they were able to avoid domestic financial turmoil during the North Atlantic crisis, with the exception of some emerging economies of Central and Eastern Europe that had not been involved in similar efforts in the past. Two remarkable absences from the FSB agenda have been the links between regulations on domestic finance and those of cross-border capital flows, and the lack of initiatives to introduce better international debt workout mechanisms. These issues have been dealt with in the framework of the International Monetary Fund (IMF), and thus as part of the discussions about global monetary reform. The IMF has also been actively involved in designing better credit lines, including contingency facilities.

The global architecture for *macroeconomic* stability has not received similar attention. Such architecture includes the global reserve system (the way international liquidity is provided) and the management of the macroeconomic linkages among different economies in a system in which each country runs its own macroeconomic policies—regionally in the case of monetary policies in currency unions, notably the Eurozone. The management of macroeconomic linkages, the centre of attention in this paper, may be understood as involving at least three separate issues: (i) the evolution of global payments imbalances, (ii) the consistency of the different national or regional macroeconomic policies, and (iii) the exchange rate system. They are related, in turn, to rules on cross-border capital flows, the subject of attention of another paper.

The problems generated by global imbalances have been a major source of concern at different times, leading to discussions on the need for proper adjustment mechanisms, with exchange rates being the major focus of attention, but also monetary and fiscal policies. Global imbalances were at the centre of attention in the early days of the ‘dollar shortage’ and during the 1960s, when there was a growing sense that the international monetary system lacked adequate adjustment mechanisms. They were next the focus of the global agenda during the two oil shocks of the 1970s and the need to facilitate adjustment of the oil-importing countries and to ‘recycle’ the oil surpluses with that objective in mind. The imbalances came back in the 1980s in an entirely different form: a rapid increase of the current account deficit in United States in the first half of that decade, which was matched by the rising surpluses in other developed countries, notably Japan and Germany. They were again in the agenda prior to the North Atlantic crisis, primarily in the form of a large deficit in the United States, matched by old and new source of

¹ I use this term rather than ‘global financial crisis’ because, although it had global repercussions, the financial crisis concentrated in the United States and Western Europe.

surpluses, primarily the oil-exporting economies and Japan, in the first case, and China in the latter.

The exchange rate issues were central in the design of the Bretton Woods system and the early history of the IMF. They became a major focus of the global agenda with the growing instability of the exchange rates of major economies in the late 1960s and early 1970s, which exploded with the decision of the United States to abandon in 1971 the dollar–gold parity established at Bretton Woods, the failure to return to a system of fixed parities, and the final decision to let the exchange rates of major economies float in March 1973. They have repeatedly been back in the agenda in the form of the pressure for surplus economies to appreciate their currencies in the 1980s and prior to the North Atlantic crisis, and as the volatility and misalignment that the floating of major exchange rates generated.

Rising global imbalances and large exchange rate misalignments have been the subject of international negotiations, generally among major economies outside the IMF but sometimes using and innovating on Fund mechanisms of dialogue and surveillance. Many (or, perhaps, most) of them have failed. Pressures aimed at encouraging surplus economies to adjust have been a recurrent issue since the 1960s, when they focused on Germany, and later on Japan and China. The exchange rate system was the central issue in the early 1970s, and the collapse of the original Bretton Woods arrangement also led to the attempt to negotiate a new international monetary system in 1972–74 through the IMF’s Committee of Twenty. The Plaza and Louvre accords of 1985 and 1987 centred on the major adjustments needed in the exchange rates of the two economies with strong deficit or surplus positions: the United States, and Japan and Germany, respectively.

In turn, rising global imbalances led to the IMF initiative to launch a multilateral consultation in 2006, which did not deliver any significant results. After the outbreak of the crisis, several common actions were undertaken, in an informal way by major central banks, and in a more formal way through the Group of Twenty (G-20), with the co-ordinated expansionary policies launched in the early part of the North Atlantic crisis perhaps being the major historical success in terms of macroeconomic cooperation. The G-20 also launched during this crisis its own peer review framework, the Mutual Assessment Process (MAP), and the IMF enhanced its own macroeconomic surveillance, but the success of these mechanisms have been limited. At the time of writing, pressure has been building up on the need to face the multiple shocks of the global economy, with no significant action yet agreed.

This paper reviews these issues. It is divided into four parts, the first of which is this introduction. The second looks at the evolution of global imbalances. The third analyses mechanisms that have been put in place to guarantee the consistency of macroeconomic policies. The fourth looks at the exchange rate system—or, more properly, ‘non-system’. The issues associated with the global reserve system and cross-border capital flows are analysed in other papers (Ocampo 2014, 2015b).

2 The changing nature of global imbalances

Macroeconomic policy is perhaps the best example of the tension between the strength of globalization and the persistence of economic policies that continue to be mainly national—regional in the case of currency unions. The net result is that the world lacks a mechanism that guarantees the consistency of the macroeconomic policies adopted by the major economies, including that of economies that issue reserve assets. The major manifestation of this problem is global payments imbalance.

The major issue raised by imbalances is the asymmetric adjustment of deficit and surplus economies, which Keynes (1942–43) raised in his writing before the Bretton Woods negotiations. Owing to the international liabilities that deficit countries accumulate, they are eventually forced to adjust, either as the result of the adverse domestic effects that deficits and debts generate, or the interruption or worsening conditions of external financing—with destabilizing speculation contributing to accelerate adjustment on many occasions. Pressures to adjust are also faced by surplus economies, particularly in the form of expansionary effects of current account surpluses, capital inflows, and the accumulation of foreign exchange reserves; however, they are more responsive to domestic policies that can weaken their effects. This asymmetry implies, therefore, the risk that these imbalances will generate global slowdowns or recessions.

The situation is, of course, quite different when it involves reserve-issuing countries, and notably the United States. In this case, the major effect of surpluses or deficits is on the supply of global liquidity—which can also be generated through a capital account—and the accumulation of net asset positions of other countries vis-à-vis the United States. In the early post-war period, the major issue was the dollar shortage and, given the trade surplus that the United States enjoyed, the need to create global liquidity through capital outflows and official transfers (notably, as we will see, through the Marshall Plan). With the change from a surplus to a deficit position, the balance of payments in the United States generated a different problem since the 1960s: excess dollar liquidity, which created pressures on US gold reserves in the 1960s and, after the abandonment of the dollar-gold parity in 1971, cyclical depreciation of the US dollar.

Beyond these global risks, imbalances generate externalities on trading partners. Current account deficits may be welcome, particularly when they reflect higher investment rates associated with rapid economic growth that are financed by foreign savings. However, on other occasions, countries may be concerned that deficits are negative spillovers of exchange rate undervaluation or other policies of trading partners. In turn, authorities may respond to deficits by increasing domestic protection or increasing export incentives, which other countries will regard as negative spillovers.

The need for proper and hopefully symmetrical adjustment mechanisms has been at the centre of global debates since the negotiations leading to the Bretton Woods agreement. They include, in particular, the role that the exchange rate plays in correcting balance-of-payments disequilibria. This principle was enshrined in the IMF Articles of Agreement in the form of the possibility of modifying exchange rate parities when countries faced fundamental disequilibria in their balance of payments. It was also agreed that all countries would be subject to IMF surveillance on their macroeconomic policies and associated peer pressure if there were signs of such policies leading to imbalances and generating negative spillovers on other countries.

However, the reluctance of surplus and even deficit countries to adjust their exchange rate parities led to a call for a more flexible system, which became a subject of increasing debate in the 1960s. With the move to a more flexible exchange rate system in 1973, the debate moved to the volatility and, even more, to the misalignments that foreign exchange markets could generate, and to the negative effects that exchange rate movements could have on trade, by generating unfair competition. In turn, it has been argued that IMF surveillance has always been considered not only a weak but also an imbalanced mechanism, as IMF staff may be less candid in the evaluation of major countries (see Section 3), and in any case Article IV consultations are unlikely to exercise only weak influence upon them. In contrast, conditionality does have strong influence on countries using IMF resources, but it is obviously only exercised vis-à-vis deficit countries, and it is, therefore, part of the asymmetric features of adjustment processes.

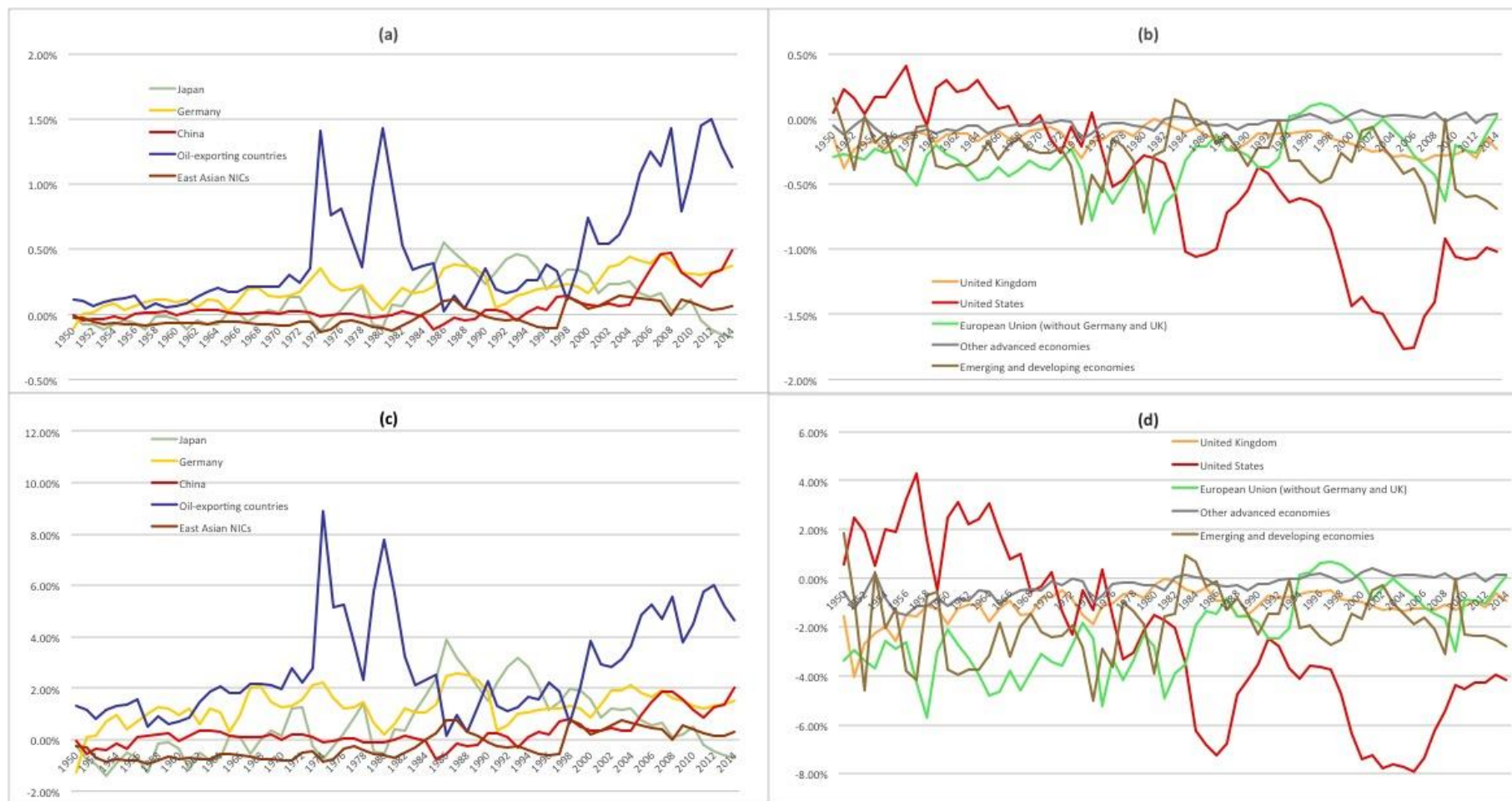
Global imbalances have been a persistent feature of the international economic system, but their nature has significantly changed through time, following a dynamics in which the correction of previous imbalances is followed by a new set of disequilibria, sometimes of a similar nature but also with novel features.

The early years of the IMF were dominated by the dollar shortage, the essential features of which were the trade surpluses of the United States and the oil-exporting countries and the trade deficit of most European economies, with significant differences among them. However, the magnitude of these imbalances was small relative to world gross domestic product (GDP) or world trade compared to what they would become later on (see Figure 1), but largely because the deficits were ‘repressed’ through a mix of protection, controls on current payments and, in some countries, multiple exchange rates. The depreciation of major European currencies vis-à-vis the US dollar in 1949 (see Section 4) may have also contributed to limit the imbalances.

The 1960s saw a transition of the United States from a trade surplus to a deficit status, as a prelude to a situation that would be a persistent feature of the major reserve-issuing country in later decades. This was accompanied by the rise of the first strong surplus position of a major European economy, that of Germany, and further accompanied by major differences in the balances of different European countries, generating tensions for Germany to appreciate its currency vis-à-vis both the United States and other European partners. Japan also moved into a surplus position in the mid-1960s but it would only become a subject of attention later on. The growing imbalances that characterized this period led to a series of debates on how to guarantee more balanced international payments (e.g. see Fellner et al. 1966; Roosa 1965) and how to replace the gold and dollar-based global reserve systems (most notably, see Triffin 1961, 1968).

The imbalances exploded in the 1970s to levels that were unknown before, in terms of world GDP and world trade (Figure 1). The source of imbalances at this point in time was the oil-exporting countries, and therefore the major issue was how to ‘recycle’ the petrodollars. The major feature of the surplus of these economies was the strong peaks reached after the 1973 and 1979 shocks, but also their rapid erosion as these economies massively increased their imports; so, in a sense, these surpluses were self-correcting. High oil prices affected many developed countries, but the imbalances that now took centre stage in the debate were those of non-oil developing countries. The unregulated and oligopolistic character of the lending by banks that intermediated the petrodollars, and the inadequate risk assessment by lenders and borrowing countries, would lead to the first major contemporary crisis in the emerging and developing world, the centre of which was Latin America (Bértola and Ocampo 2012: chapter 5; Devlin 1989).

Figure 1: Trade balances as percentage of world GDP (a, b) and as percentages of world exports of goods (c, d)



Note: Oil-exporting countries: Algeria, Angola, Iran, Iraq, Kuwait, Libya, Nigeria, Norway, Qatar, Russia, Saudi Arabia, United Arab Emirates, and Venezuela. East Asian newly industrializing economies (NICs): Hong Kong, Republic of Korea, Singapore, and Taiwan POC. GDP refers to the gross domestic product.

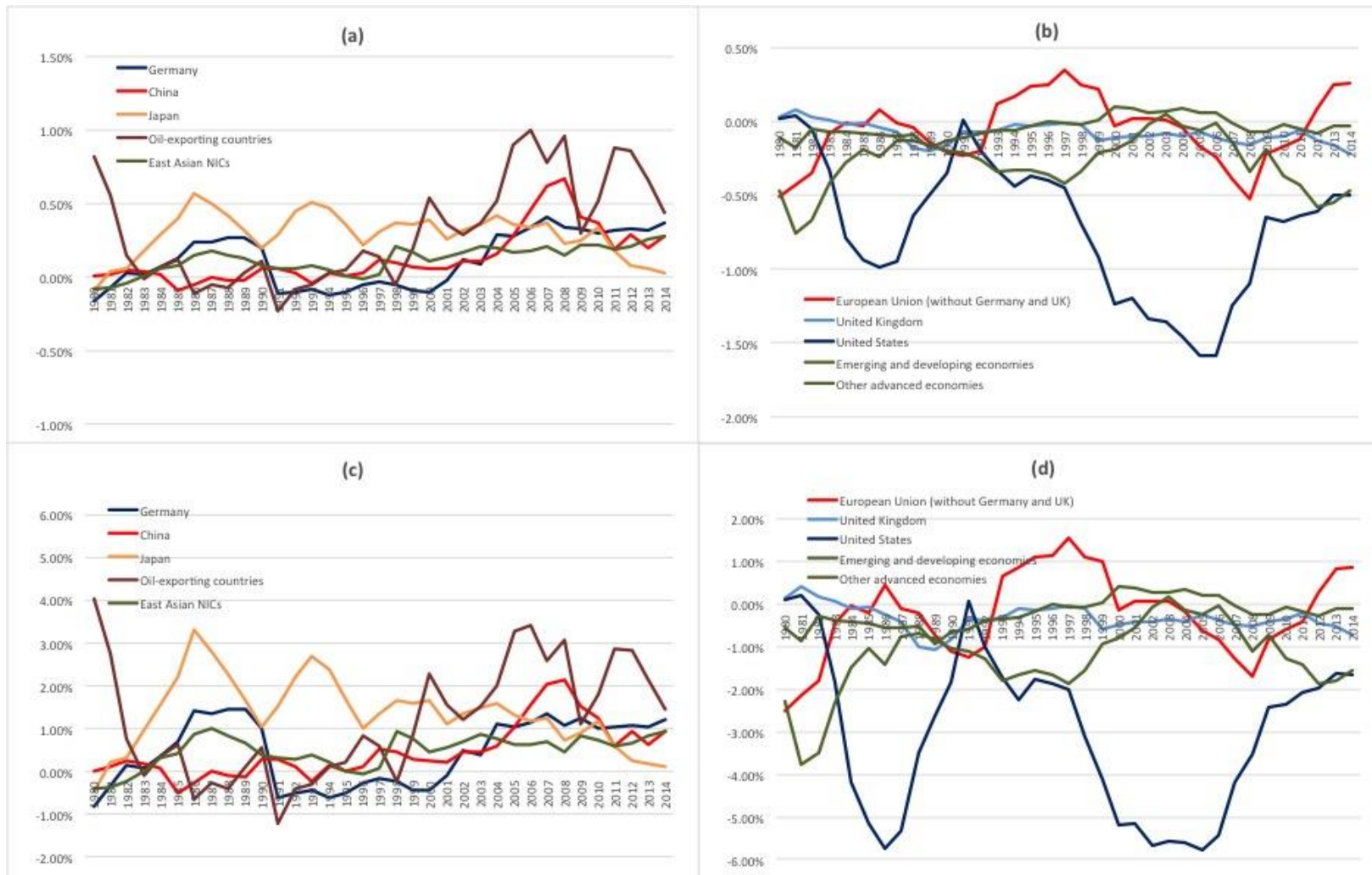
Source: Author estimates based on UNCTAD trade series.

The 1980s were characterized again by global imbalances among major developed countries, but now of a much larger magnitude than those of the 1960s and early 1970s and without the self-correcting feature that characterized the imbalances created by the oil shocks of the 1970s (Figure 1). The major source was now the massive deficit of the United States induced by the high interest rate policy adopted by the Federal Reserve in 1979–80 to break inflation and the expansionary fiscal policies of the Ronald Reagan administration that took office in early 1981. The counterpart was the surplus of other developed countries, which now had a new major actor in Japan. Germany also contributed to the imbalances with a strong surplus, as well as the correction of the deficits that other European economies and advanced countries had run during the second oil shock. Figure 2, which complements Figure 1 with consistent data on current account imbalances available since 1980, indicates that the peak imbalances were reached in 1986, after which a rapid adjustment followed, to a large extent induced by the Plaza and Louvre accords of 1985 and 1987, which forced a massive adjustment of the Japanese yen (see Section 4). Despite this, the reduction of the Japanese surplus was mild relative to the correction of the US deficit, and Japan continued to run large current account surpluses during the following decades.

A new wave of massive current account imbalances took off in the late 1990s but had two entirely different phases: the first was associated with the outbreak of the crisis of the emerging world that started in 1997 in East Asia; the second was the world economic boom of 2003–07. The main manifestation was again a rising US deficit, which experienced a massive increase since the East Asian crisis and only started to moderate at the end of the succeeding global boom. In terms of world GDP, the US current account deficit reached a historical peak in 2005–06 (1.6 per cent), although relative to global trade the imbalances were similar to those of the mid-1980s but lasted at high levels for a longer period (Figure 2). In turn, the European Union went from running a current account surplus in 2002–04 to a deficit at the end of the boom. However, this was a reflection of sharply diverging trends: a massive increase in the German surplus, but also that of a few other economies (Sweden, Netherlands, and Austria), together with rising deficits in the ‘periphery’, both in the Western ones (notably Spain, Greece, Portugal, and Ireland, in that order) and in the Central and Eastern ones (Poland, Bulgaria, Hungary, and the Baltic countries), but also in France, Italy, and the United Kingdom.

The counterpart of these pre-crisis deficits was the generation of surpluses in the emerging and developing world as a result of the strong crisis that they experienced since 1997. The surpluses of the East Asian newly industrializing economies (NICs) turned structural since then, but those of other emerging and developing countries started to moderate with their recovery in the early 2000s and, eventually, again turned into deficits. After 2003, however, the protagonists were the massive and rising surpluses in China and the oil-exporting countries. China, therefore, came to play the role that Germany and Japan had performed in previous decades. In turn, the surpluses of oil-exporting economies were more persistent than it had been after the 1973 and 1979 shocks. The resilient imbalances of Japan and a few European economies completed the sources of payment surpluses.

Figure 2: Current account balances as percentage of world GDP (a, b) and as percentages of world exports of goods and services (c, d)



Note: Oil-exporting countries: Algeria, Angola, Iran, Iraq, Kuwait, Libya, Nigeria, Norway, Qatar, Russia, Saudi Arabia, United Arab Emirates, and Venezuela. East Asian NICs: Hong Kong, Republic of Korea, Singapore, and Taiwan POC.

Source: Author estimates based on statistics from IMF International Financial Statistics and updates in the World Economic Outlook.

Broadly, the dominant characteristic of global imbalances in the run up to the North Atlantic crisis was, therefore, the massive US deficits to absorb the surpluses of China, Japan, the East Asian NICs, Germany, and the oil-exporting countries. A major effect was escalating US net liabilities with the rest of the world, a major counterpart of which were the booming foreign exchange reserves of emerging and developing countries, in particular of China and the oil-exporting countries. Although many saw the importance of these trends and their implications for global financial stability, few saw a significant problem for the global monetary system as such;² some even saw it turning into a stable Second Bretton Woods (Dooley et al. 2003). The IMF did recognize the risks associated with these imbalances and, in 2006, created a framework to monitor and eventually correct them (see Section 3).

The North Atlantic crisis led to major changes in these trends. Particularly, the US deficit fell significantly and the European Union went from a deficit to a surplus. The latter, in turn, reflected a sharp recessionary adjustment of deficits in its peripheries (both Western and Eastern Europe, with only Poland experiencing an expansion) while maintaining the large German and Dutch surpluses (those of Austria and Sweden moderated). The oil-exporting countries first experienced a short-term reduction of their imbalances but then, in 2011–12, became the major source of surpluses. The result was that the pressure to adjust in the opposite direction fell on non-oil emerging economies. The Chinese surplus was cut by half and the non-East Asian emerging and developing economies went from running a surplus to a significant deficit by 2012. One of the major mechanisms the latter faced was the strong pressure to appreciate their currencies to absorb large capital inflows. Japan also experienced a small correction of its surplus.

The asymmetric adjustments that characterize the global monetary system were clearly at work during this period. The correction of deficits in the different European peripheries and the lack of adjustment of the major surplus European economies (notably Germany and the Netherlands) are the most noticeable features. However, one complex interpretation of the Eurozone story is that monetary unification effectively led to exchange overvaluation in some countries (the periphery) and undervaluation in others (notably in Germany), a phenomenon that has shown to be costly to correct, as ‘internal devaluation’ of the periphery has not been compensated by rapid enough ‘internal revaluation’ of the centre. As the US deficit shrank, and oil-exported countries simultaneously ran large current account surpluses, non-oil emerging and developing economies outside East Asia faced strong pressures to run deficits, with large capital inflows being the most important transmission mechanism.

These trends changed significantly in 2014–15 as a result of major changes in global economic conditions: the very uneven recovery of developed countries, the slowdown of China, and the crisis in many parts of the developing world, largely associated with the reversal of capital flows and, in economies dependent on natural resource, with the collapse of commodity prices. The surplus of oil-exporting economies disappeared in 2015 and the deficit of non-oil emerging and developing countries has declined. At the same time, the US deficit started to increase again, with Germany and the rest of the European Union continuing to generate large surpluses. The Japanese and Chinese surpluses also increased, to some extent as a result of the falling cost of commodity (particularly oil) imports.

² My contributions and those of my colleagues at the United Nations were some of the few that tied these problems with the instability and inequities of the global reserve system. See Ocampo et al. (2007: chapter 4), which was based on a previous UN report. Another important exception was Stiglitz (2006: chapter 9).

As these trends indicate, there is no single cause of global imbalances. Furthermore, they reflect both structural as well as cyclical phenomena. The strong pressure for the United States to run persistent deficits is, of course, the main structural factor. Other structural factors are the surpluses of Germany (and a few other European economies) and East Asia, which have reached high levels at different times but have remained fairly resilient since then: Germany in the 1960s, Japan since the mid-1960s but particularly in the 1980s, the East Asian NICs during the crisis of the late 1990s, and China since the 2003–07 boom. As it is well known, these surpluses can be interpreted alternatively as the result of high levels of industrial competitiveness or of high savings rates. In the case of East Asian economies, several authors have understood them to be the result of an explicit development model, designed originally by Japan but later spread to other East Asian economies, which mixes an undervalued currency, lagging wages relative to labour productivity, and financial repression, to encourage high levels of savings and investment (e.g. see Pettis 2013). The surplus of oil-exporting countries is another structural feature, but it also experiences sharp cyclical variations, which were sharper in the 1970s and early 1980s than they have been in the twenty-first century. Emerging and developing countries also experienced strong cyclical variations swings associated with pro-cyclical swings in capital flows combined with those of commodity prices in natural resource-dependent economies.

3 Macroeconomic policy cooperation

To manage these imbalances, the world economy counts on insufficiently developed mechanisms of macroeconomic policy dialogue and cooperation. The IMF is the major instrument of cooperation of a multilateral character. Article I.i of the IMF Articles of Agreement defines its first purpose: ‘to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems’. In practice, however, most mechanisms of macroeconomic cooperation have operated outside the IMF through groupings of major economies, and thus predominantly as mechanisms of what I have called ‘elite multilateralism’ (Ocampo 2011) rather than through the formal multilateral organization that the world has created for that purpose. Their effectiveness has been quite diverse, and many of these negotiations have been concerned with the role of exchange rates in the system, a topic that is subject to additional attention in Section 4.

The major constraint in this area is that political incentives are heavily weighted in all countries to focus on domestic problems, with the national publics poorly disposed to make serious sacrifices to shore up international cooperation. Furthermore, in an era of growing importance of emerging economies, large majorities in developed countries see them as a threat. Therefore, international macroeconomic cooperation is only likely to succeed when there is clear view of the *national* advantages of international cooperation (Frieden et al. 2012).

The major mechanism of cooperation in the era of the dollar shortage was the Marshall Plan, which provided, in 1948–51, more than four times the drawing rights of the European countries in the IMF and more than six times the maximum obligations of the United States under the IMF Articles of Agreement (Eichengreen 2008: 96). This included the support for the European Payments Union, which served as the main mechanism to reconstruct intra-European payments and, therefore, trade (Triffin 1957), which would also allow a return to current account convertibility in December 1958. In turn, with the imbalances of the 1960s, including the implications of the end of the US surplus position but also the realignment of European currencies, the major forum for macroeconomic policy dialogue became the Economic Policy Committee (Working Party 3) of the Organization for Economic Co-operation and Development (OECD) which was made up of ten developed countries (eleven later on) and thus

became known as the Group of Ten (G-10) (Solomon 1982: chapter 3). OECD had been created in 1961 out of the former Organization for European Economic Co-operation (OEEC), which had been formed to administer the Marshall Plan. Although the G-10 was the major mechanism of dialogue, the regular discussions among authorities of major developed countries in the IMF and the Bank of International Settlements (BIS) also contributed to the, in any case, relatively weak cooperation in place. In the latter case, cooperation included the network of swap arrangements developed in the 1960s that eventually linked a dozen central banks of developed countries and the BIS (Toniolo 2005: 387–8).³

Two unique processes that did take place in the 1960s in the IMF were the discussion leading to the creation of Special Drawing Rights in 1968, as well as those on reforming the international monetary system in the IMF's Committee of Twenty in 1972–74. The IMF was a major actor in financing to manage the effects of oil shocks, particularly in developing countries, which created low-conditionality facilities for this purpose, using in part financing provided by the oil-exporting countries. (These topics are analysed in other papers of this project; see Ocampo 2014, 2015a).

The major macroeconomic policy negotiations of the early 1970s were those aimed at restoring the system of fixed parities after the United States unilaterally eliminated the dollar–gold parity in August 1971. Negotiations again took place outside the IMF, leading in particular to the Smithsonian Agreement of November 1971, the failure of which would result in generalized floating among major currencies in March 1973. Although the Committee of Twenty maintained the expectation of a return to a system of fixed parities, the end of its work in 1974 led to the final acceptance of flexible exchange rates as a *de facto* more than a desired reality and to the elimination of the role of gold in the international monetary system. These decisions were materialized in an amendment to the IMF Articles of Agreement that was approved in 1976 and came into effect in 1978 (Solomon 1982: chapters 12, 13).

The major negotiations of the 1980s among developed countries included the new *ad hoc* agreements among the Group of Five (G-5) (France, West Germany, Japan, the United States, and the United Kingdom) to depreciate the US dollar in relation to the Japanese yen and the Deutschmark by intervening in currency markets. This agreement was materialized in the Plaza Accord of September 1985, and was followed by the Louvre Accord of February 1987 among the Group of Seven (G-7)⁴ (i.e. G-5 countries plus Canada and Italy, although the latter declined to finalize the agreement) to stabilize the exchange rates after the major realignment that had taken place in previous years.

The G-7 continued to be the major forum for dialogue after that the accords. After the crisis of the emerging world that sparked in East Asia in 1997, the Financial Stability Forum (FSF) was created in 1999 as a setting of finance ministers and central bank governors of what came to be known as the G-20, to give a voice to major emerging economies, as well as Australia, Russia, and the European Union. The major task given to the FSF was that of preventing another major financial crisis—a task in which it failed miserably.

The IMF temporarily regained the initiative in 2006 with the launch of a multilateral consultation involving five major actors (China, the euro area, Japan, Saudi Arabia, and the United States).

³ This mechanism had precedents in borrowing among major central banks during crises at the times of the gold standard (Eichengreen 2008: 33–4).

⁴ The Group of Seven had a history going into the mid-1970s. It is a forum of heads of state with larger political objectives but also meet at ministers-of-finance level, including notably during IMF meetings. From late 1990s to 2014, it included Russia for some purposes, to form the Group of Eight.

The commitment of the parties were presented to the International Monetary and Financial Committee (IMFC) and the IMF Board in April 2007 (IMF 2007a), but it led to no significant results, as it lacked ownership by the leading countries and, in any case, was superseded by later mechanisms of cooperation.

The final ascent of the G-20 was sparked by the decision of the United States to convene a forum at heads-of-state level in November 2008 and the later decision of the G-20 in Pittsburgh in September 2009 to self-designate as ‘the premier forum for our international economic co-operation’. In turn, the FSF was transformed into the Financial Stability Board (FSB) to strengthen financial regulation and supervision among G-20 and a few other countries with an important role in the international financial system. It has been complemented by the informal cooperation among leading central banks, which has been critical since the outbreak of the sub-prime crisis in the United States in mid-2007, particularly through the very active use of swap credit lines such as those extended by the Federal Reserve to other developed countries’ central banks and, temporarily, to four emerging economies (Ocampo 2014). As indicated, central bank cooperation through swap arrangements went back to the 1960s, but the scale of their use to provide dollar liquidity reached unprecedented levels after the Lehman Brothers collapse in September 2008, indeed several times larger than IMF resources, although of a very short-term character. There was also a joint decision by major central banks to reduce interest rates in October 2008, but otherwise there has been no co-ordination of either interest rates or, more recently, of unconventional monetary policy (Mohan and Kapur 2014).⁵

G-20 cooperation was very successful in the initial phase of the crisis, when it assumed the form of a ‘Keynesian consensus’, leading to fairly co-ordinated expansionary monetary and, to a lesser extent, fiscal policies. Its major successes were averting a new Great Depression as well as a protectionist wave such as that which had deepened the crisis of the 1930s. However, in relation to the role of fiscal policies, the consensus broke down at the June 2010 G-20 Toronto meeting, when it became clear that there was a deep division between countries that continued to defend expansionary policies to face the weakness of aggregate demand and those that came to place priority on public sector debt sustainability. This awkward consensus on expansionary monetary policy among the central banks of developed countries was more persistent, except for the temporary lapse of the European Central Bank, which partly reversed its monetary stimulus in 2011, before shifting again to a clear expansionary policy at the end of that year. Given the asymmetries in the recovery of the developed countries, the United States also gradually moved away from expansionary policies, with the announcement of tapering of quantitative easing in May 2013, its systematic implementation in 2014, and the first increase in the rate of federal funds since the North Atlantic crisis in December 2015.

Continued monetary stimulus in advanced economies generated a major disequilibrium vis-à-vis emerging economies, which recovered faster and strongly after the North Atlantic crisis, led by China, and required, therefore, less accommodative monetary policy. This induced a strong and persistent incentive to shift capital towards the emerging world, generating strong monetary and exchange pressures—a phenomenon that came to be known as the ‘currency wars’, the term coined by the then Brazilian Finance Minister Guido Mantega. With the change in monetary conditions in the United States since 2013, the strong slowdown and later recession in many emerging economies in 2014–15, and the uncertainties surrounding the Chinese stock market in 2015–16, capital flows went into reverse, confirming once again the great volatility of flows

⁵ In any case, it can be said that there has been emulation or common learning in both areas since the North Atlantic crisis.

towards emerging and developing countries. However, in contrast to the explicit or implicit cooperation among the central banks of developed countries to avoid the deepening of the crisis and to promote a recovery, the spillovers that these policies have had on emerging economies have been generally ignored and, therefore, have not been a subject of cooperation (Mohan and Kapur 2014).

MAP, launched in 2009 in Pittsburgh to implement the ‘framework for strong, sustainable, and balance growth’, is the major instrument of macroeconomic policy cooperation among members of the G-20. In a two-step process that took place in Paris and Washington in February and April 2011, the G-20 finance ministers and central bank governors agreed what ‘the persistently large imbalances that require policy action’ are: ‘(i) public debt and fiscal deficits; and private savings and private debt (ii) and the external imbalances composed of the trade balance and net investment income flows and transfers, taking due consideration of exchange rate, fiscal, monetary, and other policies’ (G-20 2011a). This was followed by the determination of the indicative guidelines against which each of the indicators would be assessed, which are explicitly ‘not targets’ but ‘reference values’ that determine which countries would be subject to an in-depth review. For this purpose, the ministers and governors determined that complementary use would consist of economic models with statistical analysis based on each country’s historical trends, a comparison with other countries at similar level of development, and all G-20 members (G-20 2011b). It was agreed that economies that show large imbalances in at least two exercises and represent more than 5 per cent of the G-20’s GDP at either market value or purchasing power parity prices should be subject to particular scrutiny in the associated imbalance.

In practice, the IMF provides the main technical support. In particular, the IMF was asked ‘to assess the coherence, consistency, and mutual compatibility of G-20 members’ policy frameworks’ using three different activities: (i) assessing the submissions of individual countries, (ii) aggregating them to assess their mutual consistency, and (iii) making policy recommendations (IMF 2011a). This is reflected in regular IMF analyses that are presented simultaneously to the G-20 and to the IMF Board. This activity, which is defined as ‘technical assistance to G-20 members’, generates an obvious tension between the truly multilateral character of the IMF and the specific ownership of the MAP by the G-20. This tension is enhanced by the fact that G-20 decisions are policy proposals rather than enforceable strategies, and must therefore be brought to treaty-based organizations such as the IMF to be adopted by them for the global community (Derviş and Drysdale 2014). Throughout this process, non-G-20 members of the IMF find themselves in an awkward position. Therefore, a better institutional model was the consultation on multilateral imbalances that took place in the IMF in 2006–07, among a limited number of major economies accountable to the full IMF membership. As already indicated, however, this process led to no significant results.

G-20 activities have been combined with a proper IMF activity, which has been the strengthening of surveillance, both multilateral and bilateral. Indeed, it can be said that surveillance and the significant modernization of credit lines have been the two major activities undertaken by the IMF since the North Atlantic crisis, with the former perhaps having the most important global implications. This process aimed at overcoming the massive problems that were identified by the IMF’s Independent Evaluation Office (IMF-IEO 2011) in its analysis of surveillance in the run up to the crisis, particularly the lack a proper identification of financial vulnerabilities in IMF surveillance of the United States and the United Kingdom, and of a proper analysis of the links between macroeconomic and financial vulnerabilities, which in turn reflected major cultural problems in the way the IMF operated, including ‘groupthink’ and lack of capacity to ‘speak truth to power’. In more traditional language, the latter is a reflection of the lack of ‘evenhandedness’ of bilateral surveillance.

The triennial surveillance review of 2011 and prior actions taken have led to an unprecedented strengthening of IMF surveillance. At the multilateral character level, it includes the use of major IMF publications: the *World Economic Outlook* (and associated regional outlooks), the *Global Financial Stability Report*, the new *Fiscal Monitor*, launched in 2009, and the *Consolidated Multilateral Surveillance Report*. They also include reports that link bilateral and multilateral surveillance, particularly the ‘spillover reports’ for the ‘systemic 5’ (United States, United Kingdom, Eurozone, Japan, and China), the first of which was issued in 2011 (IMF 2011b) and annually since then, and the pilot External Sector Reports assessing global imbalances, which was created as a result of the 2011 triennial surveillance review, the first of which was issued in 2012 (IMF 2012). These reports aim at analysing beyond exchange rates to consider a detailed examination of current accounts, reserves, capital flows, and external balance sheets. We can add to this list reports to the G-20 (e.g. see IMF 2015) and the IMF-FSB Early Warning Exercises presented to the IMFC, the methodology of which was defined in 2010 (IMF 2010). In turn, the major instrument of bilateral surveillance continues to be the Article IV consultations. Its major changes are the more in-depth consideration of financial issues and, theoretically, more candid assessments, particularly for major economies. As part of the modernization of IMF surveillance, in 2010 it was decided that 25 jurisdictions with systemically important financial sectors must be subject to the Financial Sector Assessment Program. Parallel exercises are also undertaken by the IMF and the FSB to analyse global financial risks and by the FSB to co-ordinate regulatory reform.

It is quite clear that no elaborate system of surveillance and macroeconomic policy dialogue had been developed before the one put in place since the North Atlantic financial crisis. There has also been an improvement in the *evenhandedness* of the IMF with its different members, and in fact the more systemic economies are now a subject of stronger surveillance. The system can be criticized for its complexity and the lack of a proper integration of the risks of the real economy, which are the subject of MAP, with those generated by financial globalization, which are under the purview of both the IMF and the FSB, leading perhaps to a synthesis report on global systemic risks that becomes the major focus of dialogue and cooperation (Bradford and Lim 2014). It can also be criticized for the tension it generates between the ‘club’ character of the G-20 and the truly multilateral character of the IMF—mixed, in turn, with the still largely unfinished agenda of IMF reform on voice and participation of emerging and developing countries.

Whether there is ‘traction’ in this process, to use a typical IMF term, and particularly in relation to major economies, is also a major question—and, in a sense, *the* main question. The system that has been put in place continues to rely essentially on a mix of stronger surveillance and peer pressure. However, such forces continue to be weak, as reflected, among others, in the limited effect that this cooperation has had in avoiding a new wave of global imbalances, as well as in guaranteeing a more symmetric adjustment of surplus and deficit Eurozone countries and avoiding the creation of a large Eurozone (and European Union) payments surplus. As indicated, limited attention has also been given to the spillovers generated by expansionary monetary policies in developed countries on emerging markets and mitigating the boom–bust cycle of external financing in emerging and developing countries generated since the North Atlantic crisis. The response to the growing global risks and vulnerabilities generated in 2014–16 by the slowdown in China, volatile capital flows, the collapse of commodity prices, and rising geopolitical tensions, recognized by the G-20 finance ministers (G-20 2016), has been perceived to be generally weak and shows, once again, the conflicting views evident since 2010 on the use of fiscal policy to sustain aggregate demand as opposed to guaranteeing debt sustainability. Some even perceive that major countries are actually immersed in a war of competitive depreciations.

So, at a future stage, it may be essential to move to more specific targets for specific macroeconomic indicators. This is what I suggest next in relation to the exchange rate. Indeed, given the centrality of exchange rate policies in guaranteeing an orderly international monetary system, this is perhaps the most critical area that the international community should explore, through the IMF, for better forms of macroeconomic cooperation.

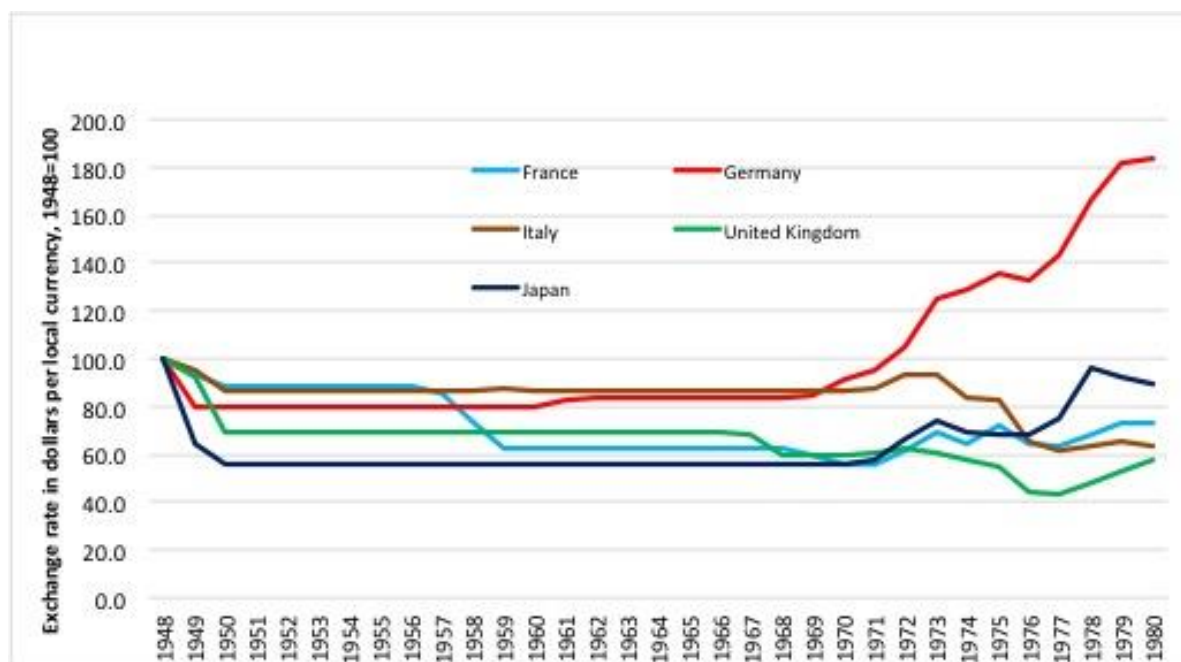
4 The exchange rate non-system

Exchange rate stability was seen as an essential element of the Bretton Woods agreement. This objective was thus explicitly incorporated as one of the objectives of the IMF, and was seen as crucial to guarantee another purpose: ‘to facilitate the expansion and balanced growth of international trade’. As this was part of the broader objective of ‘promotion and maintenance of high levels of employment’, it was agreed that exchange rates could be adjusted to guarantee simultaneous external and domestic balance. However, this was expected to be done only when economies faced ‘fundamental disequilibria’, in order to avoid the negative spillovers on other countries, in particular the competitive devaluations that were widely regarded to have badly damaged the world economy in the 1930s. It initially included the principle that large modifications of the exchange rate parities (over 10 per cent) would have to be subject to consultation with the IMF, but this rule never worked in practice.

The system of fixed but adjustable pegs worked well for over a quarter century, with some *de facto* flexibilities (Figure 3). Major adjustments were required in 1949 during the early years of the dollar shortage, which generated a strong depreciation of the major European currencies in September, with the British pound facing the strongest depreciation, followed by the Deutschmark and, to a lesser extent, the Italian lira and French franc. The yen was also effectively depreciated in April 1949, although Japan was not yet an IMF member. Major currencies were largely stable since then, with only one large adjustment of the franc in 1958. However, there was an increasing pressure to adjust major exchange rates since the late 1960s, associated with both US balance of payments as well as intra-European imbalances. They generated pressures to further depreciate the pound and the franc, but also to appreciate the Deutschmark and the yen (although in the latter case it only became effective in 1971).

The system included several *de facto* flexibilities, which have been highlighted in a now classic paper by Reinhart and Rogoff (2004). These involved multiple exchange rates and active use of parallel floating exchange rate markets (considered as cases of managed floating by these authors); in any case, according to the Bretton Woods agreement, these multiple exchange rate regimes were expected to be eventually eliminated. This practice was used by several European countries before the restoration of convertibility in 1958. In turn, Canada also adopted an explicit system of managed floating in the 1950s. Aside from the active use of similar flexibilities, middle-income countries facing a mix of inflationary pressures and balance-of-payments difficulties found the use of crawling pegs and bands increasingly attractive, particularly since the mid-1950s. Low-income countries were more commonly under a fixed exchange rate than middle-income countries. For this reason, as estimates by these authors indicate (Figure 4), the predominance of fixed exchange rates during the heyday of the Bretton Woods currency arrangements was stronger in high- and low-income countries, with the former gradually moving in the 1950s and 1960s from using the aforementioned flexibilities to strict pegs. Needless to say, during the decolonization process that took place during these years, most countries left the currencies or currency unions with the imperial powers and created their own national monetary systems.

Figure 3: Nominal exchange rates, 1948–80



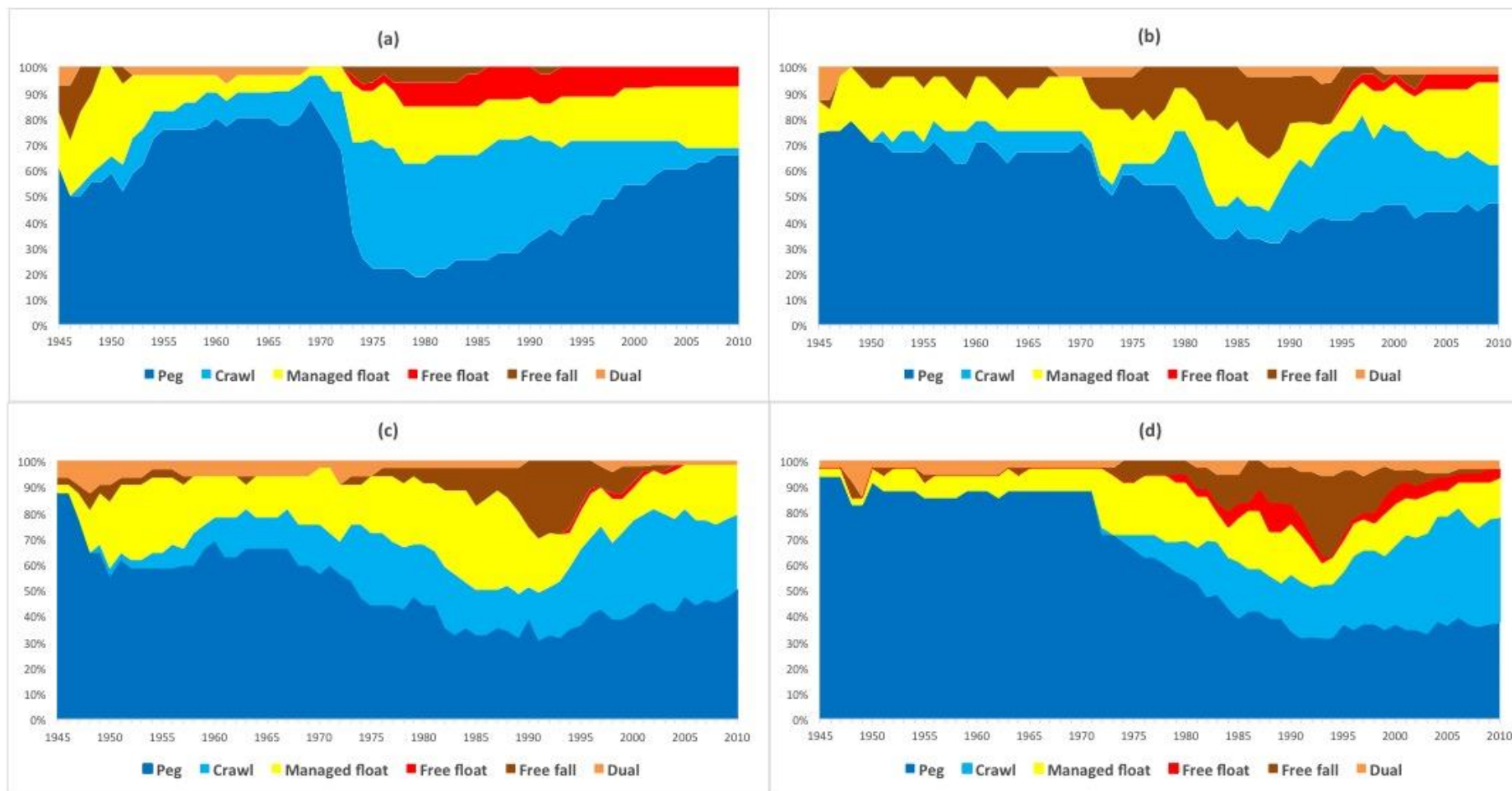
Source: IMF International Financial Statistics.

In the light of the growing global imbalances that characterized this period, discussions in the 1960s increasingly focused on whether the international monetary system had effective adjustment mechanisms and, particularly, whether it should move into a system of more flexible exchange rates. The very early defender of flexible rates was Friedman (1953). The debates of the late 1960s and early 1970s can be illustrated with the argument in favour of flexible rates by Johnson (1970)—similar in many ways to those proposed early on by Friedman (1953)—and those in support of fixed exchange rates by Kindleberger (1970, 1972).

Flexible rates were basically defended on the grounds that they generated an automatic mechanism of adjustment while at the same time giving national macroeconomic and, particularly, monetary policy the freedom to focus on domestic objectives, choosing the mix of unemployment and inflation that they found desirable. According to these views, flexible rates also helped eliminate the balance-of-payments rationale for interventions in international trade and capital movements, as well as the destabilizing speculation that could be created by expectations of changes in currency pegs. In any case, it was accepted that small countries were unlikely to enjoy much monetary autonomy and, for that reason, that they should continue to peg to a major currency.

In turn, the defence of fixed exchange rates was based on the fact that they facilitated fair international trade by reducing the uncertainties associated with exchange rate variations and costs of hedging to manage such uncertainties. The defenders of fixed rates also held the view—based on past history, particularly that of the 1930s—that flexible exchange rate markets were characterized by market imperfections and destabilizing speculation. According to Kindleberger (1970, 1972), flexible exchange rates would also eliminate the public good of international money as a unit of account, store of value, and standard of deferred payment, particularly if the major international currency (the US dollar) eventually became part of a system of flexible rates—as it soon did.

Figure 4: Exchange rate regimes from 1945 to 2010 in (a) high-income, (b) upper middle-income, (c) lower middle-income, and (d) low-income countries



Note: Income categories according to World Bank, using income levels of 2000.

Source: Author estimates based on Ilzetzki et al. (2008), using their 'coarse' classification.

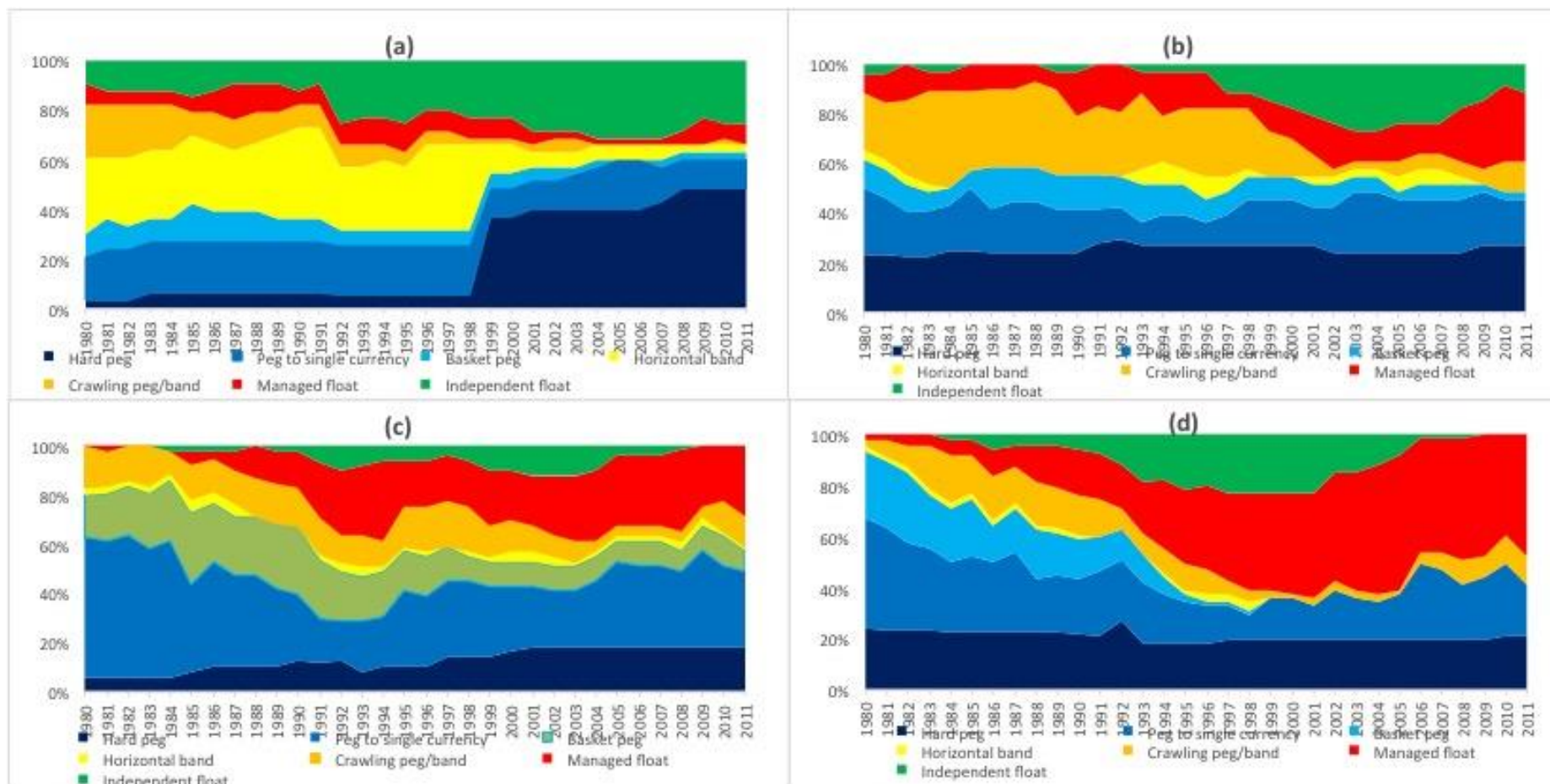
Given the predominance of fixed rates in both high- and low-income countries, the breakdown of the Bretton Woods exchange rate arrangements was sharp for these two groups of countries, but particularly for the former. In the case of high-income countries, there was, however, a major divergence between the decision of the United States and Japan to float (in the latter case with several other forms of interventions) and that of European countries to maintain less exchange flexibility among themselves and jointly float vis-à-vis the US dollar through the system initially known as the ‘snake’, which formally became the European Monetary System (EMS) in 1979. This was clearly associated with the view that limited flexibility was essential to guarantee fair trade in deep integration processes, such as the European Union’s (at the time European Economic Community’s) single market.⁶ What this implied is that the original Bretton Woods ‘fixed but adjustable pegs’ system remained in place within Europe, with somewhat larger flexibilities. After the EMS came under stress in 1992, largely because of the decision to consolidate the single market by eliminating all regulations on cross-border capital flows, this led to the decision that deep integration required a common currency—as of course is true in integrated national markets. The remaining elements of the Bretton Woods-type arrangement of the EMS thus gave way to the currency union in 1999. This decision, plus the expectation of candidate countries to join, and the requirement of stable exchange rates had to be in place for several years before joining, generated the renewed trend toward fixed rates in high-income countries shown in Figure 4.

Trends in the middle-income countries were quite different. For the two groups of middle-income countries shown in Figure 4, which had been more actively using some form of exchange rate flexibility, the transition of the early 1970s was less sharp. In any case, fixed exchange rates were increasingly abandoned by both these two groups as well as the low-income countries. Floating became more common among all these groups, but to a large extent forced by high levels of inflation, giving rise to a special category that Reinhart and Rogoff (2004) characterize as ‘free falling’ exchange rates. This category increased in the 1970s and 1980s, peaking in the early 1990s before falling sharply, as part of the worldwide reduction in inflation rates.

An interesting feature of the transition was, in any case, that the system of freely floating exchange rates defended by Friedman (1953) and Johnson (1970) continued to be rarely used, except among major currencies. Since it was adopted by the U.S., one of its major implications is that the core currency of the system, the fiduciary dollar, became an unstable currency, losing the essential advantages of international money highlighted by Kindleberger (1970, 1972). Most European countries moved into a currency union whereas most developing countries, but also some developed countries (including the earlier champion of flexibility, Canada), ended up in some form of managed floating. Indeed, according to an alternative classification of exchange rate regimes offered by Ghosh et al. (2015), the popularity of greater flexibility increased among emerging and developing countries in the 1990s only to give way to more managed flexibility after the crises they experienced in the late twentieth century (see Figure 5). Interventions in foreign exchange markets responded to the basic indictment of Williamson that ‘the exchange rate is too important to be treated as a residual’ (1983: 59). However, it implied a pragmatic rejection by authorities of many countries of what came to be known as the bipolar view defended by Fischer (2001), among others, according to which only freely floating exchange rates or hard pegs are stable exchange rate regimes (I return to this issue later in the discussion).

⁶ See an excellent analysis of the predominance of this over other objectives of exchange rate policy in Wyplosz (2006).

Figure 5: Exchange rate regimes from 1980 to 2011 in (a) high-income, (b) upper middle-income, (c) lower middle-income, and (d) low-income countries



Note: Income categories according to World Bank, using income levels of 2000.

Source: Author estimates based on data from Ghosh et al. (2015).

The breakdown of the original Bretton Woods arrangement thus gave a veritable ‘non-system’, characterized by the proliferation of exchange rate regimes and even open divergence of regime trends among countries with similar levels of development. This was based on the principle agreed in 1976 that they were free to choose any exchange rate regime they prefer. The only constraint, according to new Article IV of the IMF Articles of Agreement then approved was that countries should ‘avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members’.⁷ This was also the centre of the June 2007 decision on bilateral surveillance, which replaced the 1977 decision on surveillance of exchange rate policies that had been adopted after the collapse of the Bretton Woods arrangement (IMF 2007b). The essential problem, of course, is that the IMF has failed to determine what ‘manipulation’ means.

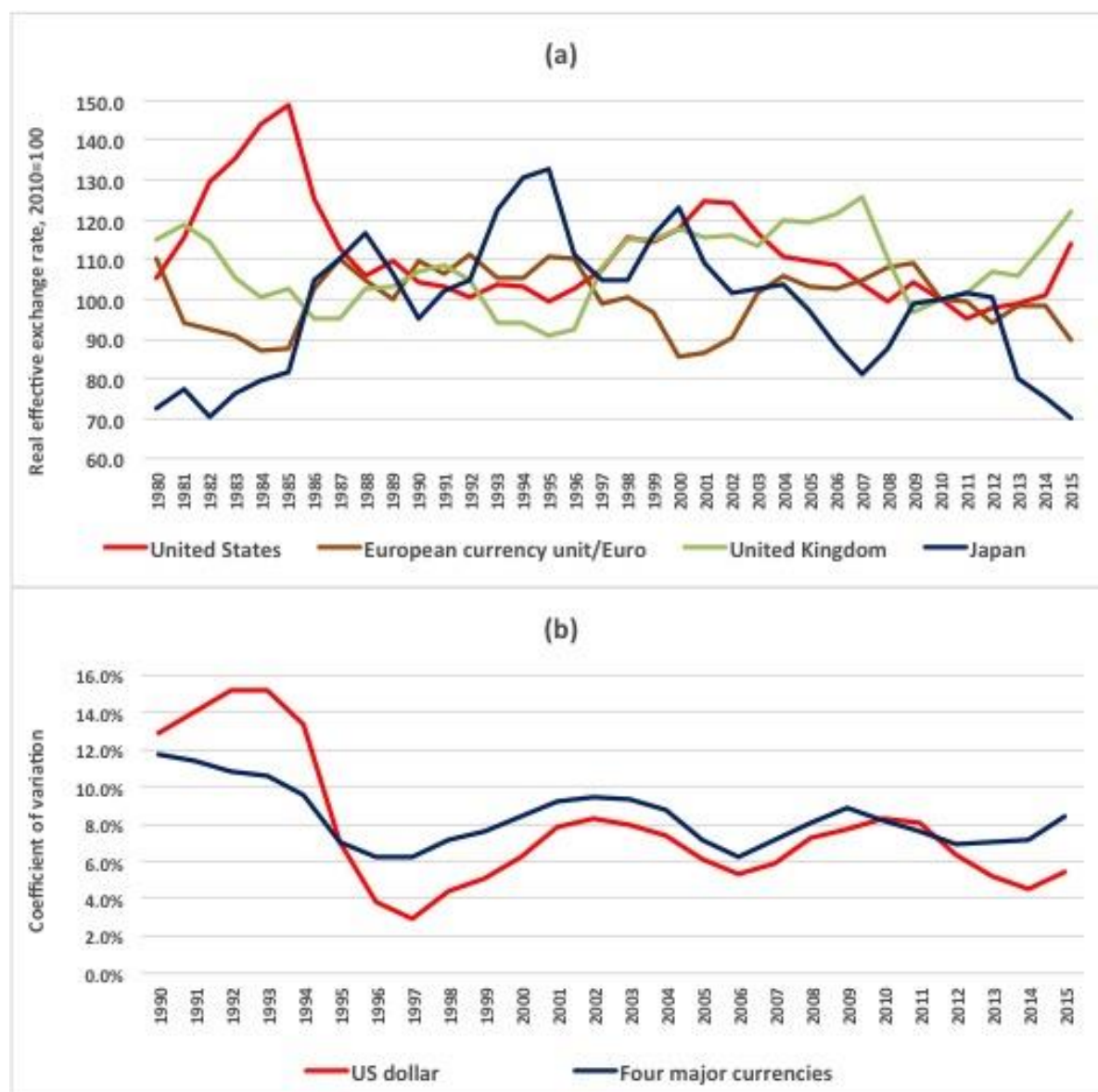
The centrality of the exchange rate regimes is derived from three different factors: (i) their effects on international trade, (ii) their central role in correcting global payments imbalances, and (iii) the potential role that exchange rate regimes have on the macroeconomic stability of individual countries. Of course, we should also take into account that exchange rate movements may also reflect divergence in other macroeconomic policies.

In relation to the first issue, a major concern is that there is no mechanism linking world trade and exchange rate rules. This is paradoxical, given that exchange rate movements can have stronger and faster effects on trade than the painstaking negotiations on trade rules. For this reason, some have suggested that exchange rate issues should be brought into the World Trade Organization’s dispute settlement mechanism (Matoo and Subramanian 2008). However, this may end up weakening one of the few successful mechanisms available at the international level. This decision would also leave aside the fact that exchange rates have many other macroeconomic dimensions, which is essentially why they should be under IMF jurisdiction.

In relation to the second issue, the exchange rate non-system has also failed to meet two additional purposes set out in the IMF Articles of Agreement: to ‘lessen the degree of disequilibrium in the international balance of payments’ and ‘to promote exchange stability’. One basic reason for that is that exchange rate movements are essentially determined in the contemporary world by financial flows, which may follow patterns that have little relation with ‘macroeconomic fundamentals’. Following Williamson (1983, 2007), it is useful to differentiate between volatility and misalignment. There is no doubt that, although the previous system had been generating growing instability of the exchange rates of major countries, the new system generated additional volatility (see Figure 1). Measured by real effective exchange rates, volatility peaked in the early 1980s, associated with the major appreciation and later depreciation of the US dollar, and massive appreciation of the Japanese yen and, to a lesser extent, of European currencies, which were the focus of the Plaza and Louvre accords. However, exchange rate volatility among major currencies has remained an essential feature of the system, and tends to increase during crises, particularly owing to the volatility of the exchange rate of the US dollar (see Figure 6).

⁷ See a broad discussion of the implications of the new Article IV in IMF (2006).

Figure 6: Instability of four major exchange rates: (a) real effective exchange rates and (b) coefficient of variation



Note: Real effective exchange rates are calculated using consumer price index (2010=100), and the coefficient of variation is a moving average ending in the year indicated.

Source: Estimates based on IMF International Financial Statistics.

An additional concern is whether exchange variations help correct balance-of-payments imbalances or not, in the latter case either because of the lack of response of current account to exchange rates or because of exchange rate misalignments—understood as movements in the opposite direction to what would be required to correct existing current account imbalances. Some authors have argued that the degree of exchange rate flexibility has no effect on the current account adjustments (Chinn and Wei 2008), but others have claimed they do (Ghosh et al. 2013), with the proper specifications of exchange rate flexibility being a critical issue. It can also be argued that exchange rate volatility has not had a negative effect on world trade, as reflected in particular in the trade boom that the world economy experienced in 1986–2007,

during which real export growth reached levels similar to the ‘golden age’ (1950–73) of post-war developed countries and the elasticity of trade to world GDP reached a historical peak.⁸

A more important problem, therefore, is the fact that exchange rates do not always respond to fundamentals, incorporating all the information available at a specific moment of time, but rather follow boom–bust financial cycles or random walks in which forward markets follow the spot market instead of helping reduce the uncertainties associated with variations in current rates (Williamson 1983, 2007). The results are the major misalignments that characterize foreign exchange markets and help generate the global imbalances that periodically erupt in the system. In recent times, for example, this is reflected in the major growing surplus of the Eurozone that coincides with the weakening of the euro, and the pressure on the US dollar to appreciate which in turn again increases the US deficit.

In relation to the third issue, there is now a broad-based agreement that, according to the traditional defence of exchange rate flexibility, an inadequately flexible exchange rate system and soft pegs generate significant macroeconomic and financial vulnerabilities—recession and balance-of-payments risks, in the first case, and excessive credit expansion, foreign borrowing, and exchange rate mismatches in portfolios, in the second. However, there is growing consensus that the bipolar view is wrong. Hard pegs may be more sustainable, but do generate major recession risks, as strikingly shown by the experience of Baltic countries and the Eurozone periphery during and after the North Atlantic crisis. Although some intermediate regimes, particularly those with insufficient flexibility, are associated with higher risk of crises, other intermediate regimes, which Ghosh et al. (2015) refer to as ‘managed floats’ do reduce the risk of crises and are compatible with a large element of monetary policy autonomy (see also Fischer 2008; Frankel 2004). This also shows why the pragmatic choice of intermediate regimes makes sense, including through interventions aimed at correcting misalignment, very active counter-cyclical foreign exchange reserve management, and, in some cases, use of capital account regulations—or, in other words, that some forms of ‘fear of floating’ (a phrase coined by Calvo and Reinhart 2002) are justified.

The system could be improved by introducing elements that enhance the capacity of exchange rate to contribute towards correcting global imbalances and to provide a reasonable level of macroeconomic and financial stability. Returning to fixed exchange rates among major currencies is, of course, impossible, because of the magnitude of capital flows, but also inconvenient, given that exchange rates must serve also to adjust different priorities of macroeconomic policies among major countries. The best system is probably one of reference rates among major currencies, suggested soon after the breakdown of the Bretton Woods agreement by Ethier and Bloomfield (1975), and later on, in different variants, by Williamson (1983, 2007). This implies that major countries would follow some form of managed floating around multilaterally agreed parities or bands—which could be very soft bands. One of the advantages of such a system is that it would also give some guidance to markets, which may help avoid extended periods of deviation from equilibrium. Interventions in foreign exchange markets but also other macroeconomic policies would support the movement of exchange rates towards the agreed parities or bands (i.e. reinforce depreciation if the currency is perceived to be overvalued and appreciation if it is undervalued). Intervention rules would provide an implicit

⁸ Using United Nations data, real exports reached two periods of fast growth after the Second World War: 1950–74, when they grew at 7.4 per cent a year, and 1986–2007, when they grew at a rate of 7.3 per cent. However, the elasticity to world gross domestic product at market exchange rates was much higher in the latter than in the former period: 2.39 versus 1.55.

definition of what ‘manipulating’ the exchange rate means: interventions that push the exchange rate away from the agreed parities.

In this framework, the process leading to the determination of exchange rate parities would have to take into account all macroeconomic determinants of exchange rates, and would thus summarize a significant amount of information. A simpler approach would be to look directly at payments imbalances, and particularly at current account imbalances, which, as we know, is equivalent to looking at saving-investment imbalances. This could be done, for example, by defining current account target zones, and it is recognized that the focus should be on the effects of overall economic policies on national savings and investment, not just on exchange rate policies; this is consistent with the strong views of Pettis (2013).

Even better would be to look at payments imbalances among countries together with global macroeconomic imbalances; that is, measures of the global output (employment) gaps and global inflationary or deflationary pressures. Furthermore, they could include the broader set of indicators chosen by the G-20 for its MAP. In any case, complexity may not be a good starting point for an incipient process. For that reason, a simple set of indicators may be better. This is why the reference exchange rate proposal is a good idea, complemented with information on current account deficits and global output gaps.

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