The International Monetary System

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Overture

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

  -- Global liquidity needs
  -- Exchange rates and external imbalances

• Today’s incarnations of these problems differ from those of the Bretton Woods era, pre-1973

• I will focus on *liquidity* today.
Financial Globalization a Major Change

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

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

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

Source: IMF, COFER database
Systemic Problems from Self Insurance

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

• There is a modern-day *Triffin paradox*

• Clear recent statement by Farhi, Gourinchas, Rey, “Quelle reforme pour le systeme monetaire internationale?” (January 2011)

• If reserve demanders prefer safe government debt (they may not), gross debt may have to rise beyond fiscally prudent levels – making it risky!

• “Internal contradiction” is due to asymmetries in economic growth rates, creditworthiness
Output shares of advanced and emerging/developing economies (at PPP)

Source: WEO database, October 2010; projections after 2009
International Reserves versus Public Debts

Global nongold reserves compared with gross general government debt

Source: IFS and WEO database

USD billions

US government debt
Eurozone government debt
World reserves

Source: IFS and WEO database
Better Ways of Meeting Liquidity Needs

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

• Outright reserve pooling superior to transactions involving SDRs and currency transformation

• Credit lines in multiple currencies diminish dollar’s singular role as reserve currency (but not as vehicle currency, where it is by far dominant)

• *Liquidity vs. solvency:* Need to promote orderly sovereign debt resolution procedures

• A larger scale of IMF operations raises in a major way the issue of *fiscal backup* by member governments – much as in the European context
Deeper Moral of All This…

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

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

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