

Seminar on the International Monetary System
Introduction

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19 January 2011

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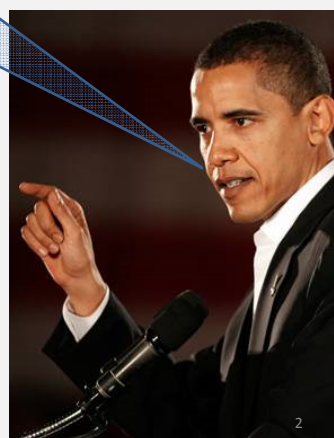
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Motivations

"It is undervalued".

"And China spends enormous amounts of money intervening in the market to keep it undervalued."

Barack Obama, 12 November 2010



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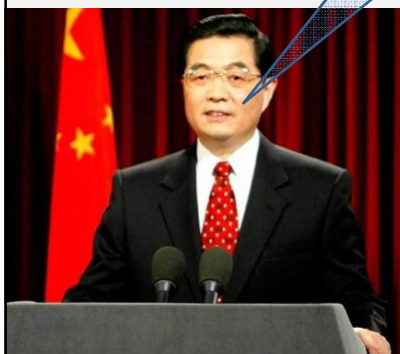
Motivations

"The current international currency system is the product of the past.

As a major reserve currency, the U.S. dollar is used in considerable amount of global trade in commodities as well as in most of the investment and financial transactions.

The monetary policy of the United States has a major impact on global liquidity and capital flows and therefore, the liquidity of the U.S. dollar should be kept at a reasonable and stable level."

Hu Jintao, 17 January 2011



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A cold topic getting hot again?

Discussion:

- Lively under Bretton Woods, revival in the 1980s with target zone proposals, essentially stagnant since the 1990s.
- Because:
 - Lessons from target zones: big countries don't abide by international arrangements,
 - Love of floating (cum inflation targeting)
- Topics of interest during this period:
 - Regional arrangements (in Europe, possibly other regions)
 - Choice of exchange rate regime (for emerging countries)
 - Crisis management and resolution (for fixers)
- Recent revival (will it last?)

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What has changed?

- Disputes over the role of the IMS in the crisis
- Lessons from history: international monetary disputes can wreck trade and financial integration (and more)
- RMB controversy, currency wars
- Unprecedented accumulation of foreign exchange reserves
- Reintroduction of capital controls

- IMS a priority of French G20 presidency

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But..

- Many US academics consider the only issue of interest is the undervaluation of the RMB
- Views differ widely on the benefits (and costs) of issuing an international currency
- Loose integration between international money and international macro
- Proposals for reform often inspired by outdated representations of international interactions

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Goals of seminar

- Analytical approach
 - Clarify issues
 - Clarify concepts
 - Clarify alternatives
 - Attempt at analytically-based assessment

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Basic concepts and a preview of the issues

International monetary system (IMS):

1. Convertibility of currencies and management of capital flows
 2. Exchange-rate regimes and policies
 3. Rules and mechanisms for liquidity provision
 4. Policy surveillance and cooperation
 5. International currency or currencies
- Systems have historically involved principles along those four directions
 - However no system has been 'chemically pure', all systems have been hybrid to some extent
 - Regime rather than system (less normative)

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1. Convertibility

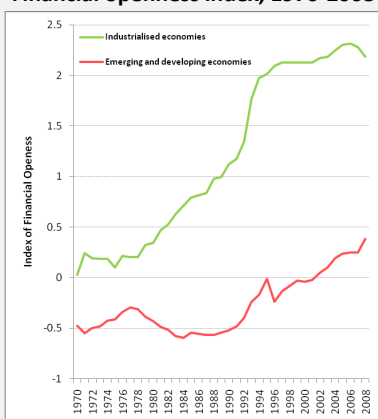
- Current account convertibility (of money into goods) now general
 - Not as obvious as it seems today (think of the USSR)
 - Was achieved in the early 1960s in the advanced countries, later in the developing countries
- Financial account convertibility (of money into assets)
 - Was achieved in the early 1990s in the advanced countries, not yet complete in the developing countries
 - Uneven evolution (fast in Eastern Europe, slow in East Asia)
 - Recent reintroduction of capital controls
 - More acceptance of capital controls as last line of defence (Ostry et al., 2010)

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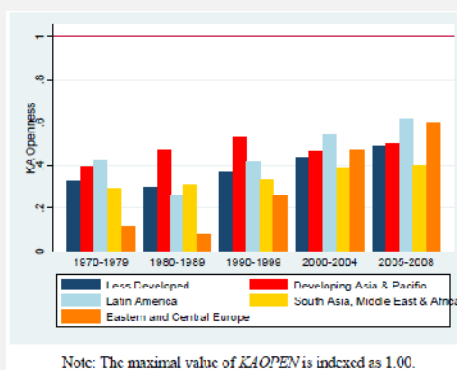
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Financial openness

Financial openness index, 1970-2008



Financial openness by region, 1970-2008



Source: Chinn and Ito database http://web.pdx.edu/~ito/Chinn-Ito_website.htm

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Capital controls are back

Table 2: Examples of capital controls and related measures

Country	Measures taken or considered
Brazil	Two increases in October of the financial operations tax (IOF) applicable to incoming foreign investment in fixed-income instruments and funds. Increased tax on margin deposits for derivative contracts of non-residents, aimed at reducing the profitability and volumes of foreign-exchange contracts.
Indonesia	Announcements by the government of a minimum holding period for central bank bills.
South Africa	Reserve accumulation, loosening of exchange controls for capital outflows of residents and raising of the maximum investment authorised overseas.

South Korea
Bill submitted by South Korean lawmakers in November to impose a 1.4 percent withholding tax on interest income on bonds bought by foreign investors as well as a 20 percent capital-gains tax. Auditing of banks handling foreign derivative contacts.

Specific measures announced in July to mitigate the volatility of capital flows: ceilings on FX derivative positions of banks, regulations on the use of foreign currency loans, tightening of regulation on foreign currency liquidity of banks.

Thailand
Introduction of a 15 percent withholding tax in October, applicable to interest income and capital gains on Thai debt for foreign investors. Officials have announced that they are studying the use of levies to control capital inflows, but not for short-term use.

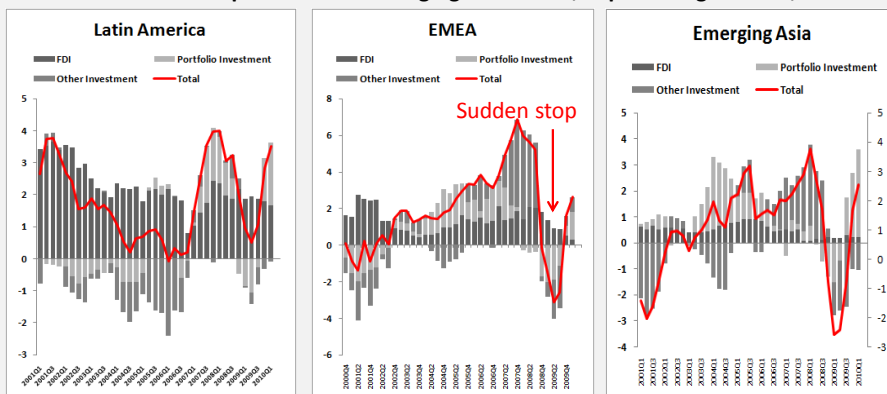
Source: Darvas and Pisani-Ferry (2011)

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Why? High volatility of capital flows, sudden stops

Recent evolution of capital flows to emerging economies, in percentage of GDP, 2000-2010



Source: Bénassy-Quéré and Pisani-Ferry, 2011

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2. Exchange-rate regimes and policies

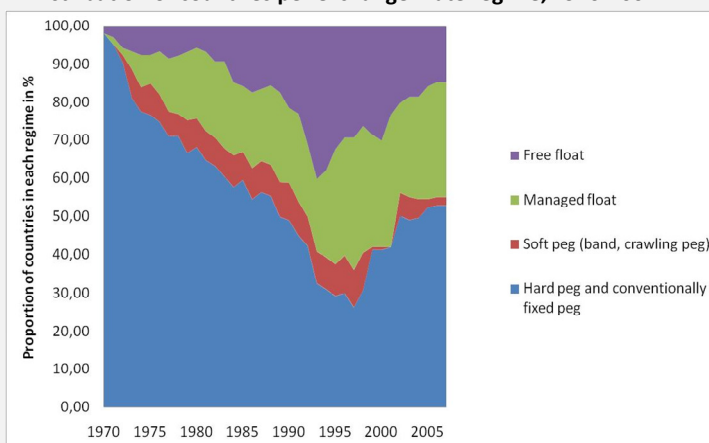
- Pure IMS involves exchange-rate regime uniformity (but for the hegemon)
- In reality variety of exchange-rate regimes at each point in time
 - Whole range of possible regimes
 - Different choices across countries and over time
- Why?
 - Different situations and preferences
 - Hollowing out of intermediate regimes
 - Regional clusters

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A variety of exchange rate regimes since the end of Bretton Woods

Distribution of countries per exchange –rate regime, 1970-2007



Source: Ilzetzki, Reinhart and Rogoff (2008) based on IMF data

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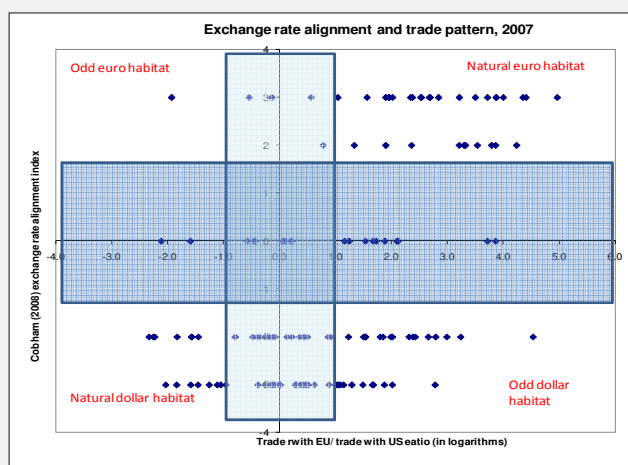
A few facts

- 92% of currencies in a de facto peg between 1999 and 2004, of which 56% were on a dollar peg (Bénassy-Quéré, Coeuré and Mignon, 2006)
- In 2007 dollar zone amounted to 36% of non-US world GDP (Goldberg, 2010)
- Euro pegs are mostly regional, whereas the reach of the dollar is global (Pisani-Ferry and Posen, 2009)
- Whereas the advanced countries have moved to floating, a large part of the emerging and developing world is in a Bretton Woods 2 regime (Dooley, Folkerts Landau and Garber 2003)

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Trade and pegs



Source: Bénassy-Quéré and Pisani-Ferry, 2011

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3. International liquidity

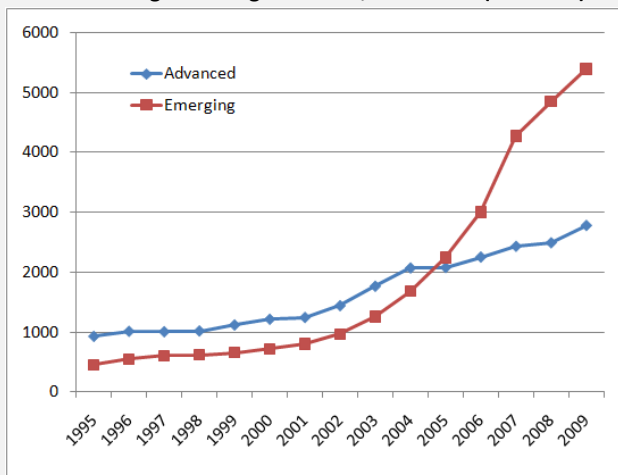
- Capital controls not a response to sudden stops
- Rather,
 - Reserve accumulation at national level (self-insurance)
 - Multilateral (IMF), regional (Chiang Mai) or bilateral facilities to substitute private inflows (financial safety nets)
- Reserves are costly (investment of national savings in low-yielding assets) and risky (exchange-rate risk)
- Rather, collective insurance is in principle the right response:
 - Less costly, less limited
 - Evolution of multilateral doctrine towards more money, less conditionality (IMF's *Flexible Credit Line*)

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However developing countries prefer to accumulate reserves

World foreign exchange reserves, 1995-2009 (\$ billions)



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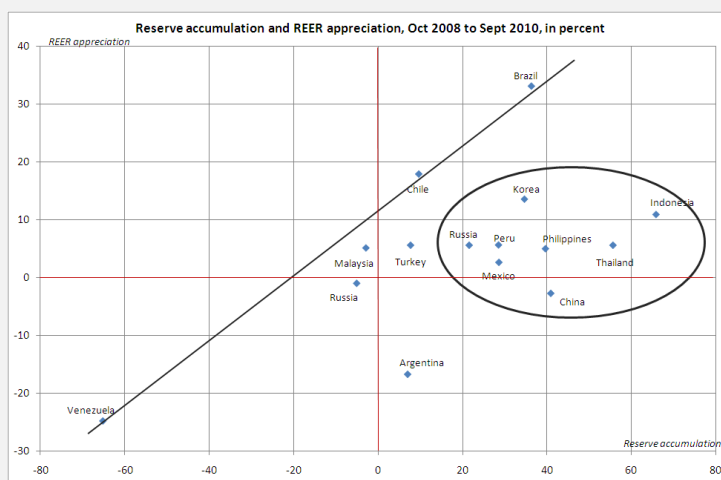
Why? Variety of explanations

- Need for larger reserves as potential for outflows increases
- Lack of appropriate facilities, fear of conditionality
- Distrust for IMF
- International organisations may not suffice in times of crisis
- Exchange-rate merchantilism

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Not all countries behave the same way



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Source: Bénassy-Quéré and Pisani-Ferry, 2011

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4. Surveillance and cooperation

- 'Own house in order' doctrine sees no valid motive for cooperation
- However discussions on:
 - Global monetary stance
 - External deficits and surpluses – especially asymmetric burden of adjustment
 - Crisis response leadership
- Recent revival of coordination (G20 London summit, Pittsburgh summit's *Framework for strong, balanced and sustainable growth* and MAP)
- Coordination and surveillance can take place at global or regional levels (neither is effective)

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Topics for analysis

- Venues for coordination (G7, G20, IMF..) and their governance
- Principles for surveillance (objectives, targets and instruments)
- Asymmetry

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5. International money

- “Money is a convenience and this restricts the number of currencies” (Mundell, 1961)
- Fully applies to international currencies. In fact one currency has dominated most of the time.

Functions of international currencies (adapted from Krugman, 1991)

Function	Private sector	Public sector
Means of payment	Vehicle	Intervention
Unit of account	Denomination	Anchor
Store of value	Investment	Reserve

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Still one dominant currency

Indicators of the international role of key currencies (percent of world total)

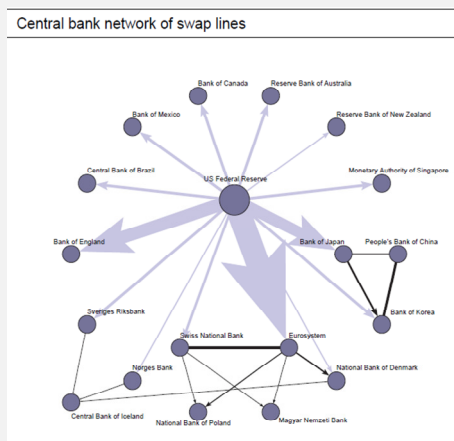
	Dollar	Euro	Yen	Other
Forex market turnover, April 2010 (/200%)	84.9	39.1	19.0	57.0
Outstanding international debt securities, end 2009 (excluding domestic issues)	45.8	21.4	5.8	17.0
Outstanding international bank loans, end 2009 (excluding trans-European loans)	53.8	15.7	3.6	26.9
Allocated foreign exchange reserves, end 2009	62.2	27.3	3.0	7.5

Sources: ECB (2010), BIS (2010).

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US still at the centre at the height of the financial crisis



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Source : McGuire et von Peter, 2009

Questions

- Implications of issuance of international currency (exorbitant privilege)
- Triffin dilemma
- Is an hegemonic system more stable?
- Would a multipolar system be preferable?
- How fast / how destabilising the transition?

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Conclusions

- Scattered field
 - Theory
 - Facts
 - History
 - Politics
- Need for consistency in approach