G7 2019 Conference:

« Bretton Woods : 75 years later – thinking about the next 75 »

Banque de France (Paris)
16 July 2019

Summary

Under the French Presidency of the G7, Banque de France and the French Ministry for the Economy and Finance organized a high-level conference on the occasion of the 75th anniversary of the Bretton Woods agreements.

François Villeroy de Galhau, Governor of Banque de France, stressed in his Welcome Address the remarkable resilience of the Bretton Woods institutions and underlined two of their major successes: tackling the great financial crisis, and supporting a prodigious development of globalization which generated a lot of benefits, from spectacular poverty reduction to increase in productivity. However, these successes have generated fragilities and challenges that must be addressed. Tackling the crisis has necessitated strong interventions of monetary authorities, which are currently challenged. The Governor recalled that monetary policy cannot do everything; it must be conducted in full independence, be data dependent, and is not a substitute to structural reforms. Safeguarding financial stability is key. The disturbing effects of capital flows on emerging and developing economies and the growing global (financial) imbalances call for greater cooperation and a reinforcement of the global financial safety net (GFSN), notably through a better use of precautionary arrangements to protect innocent bystanders. Regarding the other success of Bretton Woods institutions -- expanding globalization -- the challenges are to resist protectionism, to recognize winners and losers of globalization and take appropriate policy actions. Bretton Woods Institutions must better account for public goods related to the environment and inclusion. The Governor concluded by calling for a new harmony in the multilateral system including, well beyond the Bretton Woods institutions, as far as the UN system, as a guiding principle for the next 75 years.

Bruno Le Maire, French Minister for Economy and Finance, called in his concluding remarks for greater cooperation within the G7 to safeguard the Bretton Woods institutions challenged by the two largest world economies. Minister Le Maire also called for a new capitalism with a better regulation of its actors (and notably the "Digital Giants"), a greater reform of the Eurozone (through common budget with stabilization function, and completed banking and capital market union) in order to contribute to international welfare, and to reinforce the institutions of Bretton Woods.

The main message from the conference was a call to reinvent the Bretton Woods institutions based on four priorities: (i) fighting climate change, notably through green finance (ii) containing and reducing inequalities, (iii) reinforcing the GFSN (to safeguard financial stability) and (iv) reforming the World Trade Organization (WTO) to promote a fairer globalisation.

Welcome address

Jacques de Larosière, former Managing Director of the IMF, discussed the far reaching consequences of the demise of the Bretton Woods system, which led to the non-homogeneous exchange rate regimes currently in place (with some countries adopting free floating exchange rates and others adopting fixed or managed exchange rates). The policy coordination at the heart of Bretton Woods became elusive, leaving the floor to a non-system where most countries intervened on the exchange rate market. It has resulted in the massive accumulation of international reserves, a global increase in leverage, and excess liquidity enabling governments to borrow without enough constraints. In addition some structural reforms have been postponed due to the ease to borrow under the new system. The system eroded the confidence in money, led to trade distortions and beggar-thy-neighbor policies, and global imbalances. Excessive public debt still remains unaddressed today. Going back to the original Bretton Woods system is nevertheless neither possible, nor desirable. Jacques de Larosière advocated for the establishment of a basket of currencies under close surveillance and monitoring of short term capital movements, and thus a move toward a monetary system with the IMF controlling and adjusting the global supply of reserves and private credit, and issuing an international currency, to limit the drawbacks of national currencies.

Panel 1: Reflecting on global economic turbulence and dealing with crises

Moderator: Hyun Song Shin, Economic Adviser and Head of Research, Bank for International Settlements

Panelists:

Barry Eichengreen, *George C. Pardee and Helen N. Pardee Professor of Economics and Political Science, University of California at Berkeley*
Patrick Honohan, *Former Governor, Central Bank of Ireland*
Helene Rey, *Lord Bagri Professor of Economics, London Business School*
Hyun Song Shin, *Economic Adviser and Head of Research, Bank for International Settlements*
Arvind Subramanian, *Visiting Lecturer, Harvard University; Peterson Institute for International Economics; Former Chief Economic Advisor to the Government of India*

The first panel took stock of the way the crisis and global instability have been tackled and the lessons that can be drawn to prepare for future crises. It was noted that US monetary policy has been a major driver for global risk appetite, and may have induced instability in emerging markets. The problem of dollar-induced instability in EMs is still very much with us. Still, this instability could have existed even in the absence of quantitative easing. Central banks acted decisively to deal with the crisis but with limited support from fiscal policy. One risk today is to rely excessively on monetary policy. Fiscal policy has to play an important role. Several speakers emphasized the need to use countercyclical macroprudential policies more aggressively, one lesson of the crisis being that policymakers failed to understand the global financial cycle or the credit cycle. These macro prudential policies are both country-specific and have a global or a regional dimension. A sophisticated macroprudential framework needs to be elaborated, with powerful diagnosis tools, wide remits (including financial actors and debtors), hard powers, refined cost-benefit analysis and tools, and accountability. There is a need for more data on the details and intensity of macro-prudential interventions for policy evaluation.

From a borrowing country perspective, the necessity to rethink the role of the IMF during a crisis was discussed. Countries relying on IMF lending would like to have access to funding on reasonable terms, and be provided with a workable program that can be sold politically. Prioritizing ownership is important. There may be a need to develop more contracyclical financing instruments, such as GDP-linked bonds.

Participants called for responding to new threats and global turbulence by enhanced cooperation. While there had been for some time an ideological convergence on the advantages of trade liberalization and globalization, an ideological divergence is materializing today, given macro-cyclical and long term concerns: the developed world is burdened with slow growth, secular stagnation, inequalities; the Rest of the World benefits from rapid growth, partly due to globalization, but needs to build state capacity to overcome the middle-income trap. A new threat to convergence is that of a de-globalization, with impacts on emerging economies using an export-based growth model. The rise of China as a hegemon is a potential source of systemic risk, due to its slowing growth due to aging, financial strains, beggar-thy-neighbor currency declines and sometimes aggressive trade and intellectual property right policies. The impact of current US policies was also discussed.

Other major threats such as climate change and massive migrations were mentioned. Participants stressed the importance of reconciling individual countries sovereignty and their systemic responsibility. Other concerns include the role played today by large financial markets and non-banks financial system, high levels of liquidity transformation, and the underestimation or lack of information on interconnections.

Panel 2: Reflecting on trade

Moderator: Martin Wolf, Associate Editor & Chief Economics Commentator, Financial Times

Panelists:

Alan Wolff, *Deputy Director-General, World Trade Organization*
Takatoshi Ito, *Professor of International and Public Affairs, Columbia University*
Keyu Jin, *Associate Professor of Economics, London School of Economics*
Anne Krueger, *Professor of Economics, Johns Hopkins University*
Cecilia Malmström, *European commissioner for trade*

The commitment to the development of global trade has produced remarkable results: since 1950, world trade volumes have increased by 39 times. Today, the 164 WTO members account for over ¾ of the world's GDP, and most world trade is done in accordance with WTO rules. In addition, the underlying agreements are based on the premise that open markets prevent wars: "trade underwrites peace". The WTO is about fairness in prohibiting discrimination.

Change of mind from the US started in Buenos Aires in 2017 when the U.S. trade representative called for reforms with respect to the developing country status, and a need for transparency. E-commerce, the impact of digitalization on services, industrial subsidies, forced technological transfers, all call for improvements in the system. Leadership and a vision as well as a renewal of consensus on cooperation and multilateralism are needed: legitimacy and inclusiveness, common purposes rediscovered, restoring the ability to make new rules, and a more effective dispute settlement process.

However, the main principles attached to the Bretton Woods system are now under threat, under the pressure of world powers. The main challenges the WTO faces are differences among members including on economic development, and popular discontent stemming from income inequality. While the U.S. had been leading the process of framing trade agreements multilaterally since World War II, now it is diverting from this course. The recent proliferation of regional agreements, concluded or under negotiation, is a challenge to the system, but a manageable one, already envisaged in the original General Agreement on Tariffs and Trade. The recent shift towards pure bilateralism is far more threatening. In the short term it may seem a way to open up economies. But departing from rules-governed multilateral trade has important negative implications. For instance, the steel tariffs imposed on a number of countries ultimately led to an increase in the price of steel imports, which harmed U.S. producers.

China is criticized for its unfair trade practice, subsidizing State Owned Enterprises, technology appropriation and intellectual property protections. But, as argued by a speaker, in 30 years, China has made enormous progress, and its success is related to its success in development and reforms. It set up a legal system compliant with international standards, but enforcement is an issue. SOEs are losing importance: the sector now accounts for 30% of China's output, less than 15% of employment and 10% of exports. There is wide acknowledgement, domestically, of the importance of the development of the private sector. U.S. demands on China related to its economic practices made China stronger and more independent technologically, as it aspired to. The demands are consistent with China's declared long-term goals, and might be unifying the political spectrum towards faster reforms. China claims its preference for solving disputes on a case-by-case basis, in relevant international fora. It wants to be an innovation-based society in an open free trade environment. The question debated by the panel is whether China is fitting in the system or trying to create a new system. It has been agreed that the rise of China in the world economy and trade is a big disruption and it creates needed adjustments in the Rest of the World.

The EU and Japan are committed to global trade. They have been affected by similar actions (i.e. on aluminum, steel) or share common concerns (potential automobile tariffs). Both are working on expanding the network of trade agreements, in particular with the Asia-Pacific region but also beyond. They remain devoted to continuing the dialogue with both the U.S. and China.

In the short run, the emergency is to find a solution for the WTO's Appellate Body (potentially entering a deadlock in December, due to the refusal of the U.S. to nominate a judge in the institution). The WTO could be deprived of its dispute resolution tool and its enforcement function. Irrespective of the longevity of the current protectionist tendencies in the U.S., numerous countries could form a common front to safeguard world trade and the WTO itself. Creating a new institution to replace WTO does not seem to be the right answer however. If the momentum is seized, reforms to its structure and procedures would be an integral part of the common response.

David Malpass, President, World Bank Group, Keynote Speech

David Malpass noted milestones of the World Bank Group's evolution, including that its first loan in 1947 was to France for reconstruction after World War II. He recalled the historical decrease in global poverty experienced in the late 20th century, and early 21st century. However, with 700 million people still living in extreme poverty, important challenges remain. In this respect, he pointed to the engagement of the World Bank Group and underlined its capacity, along with other Bretton Woods institutions, to adapt to, and cater for, new needs and changing environments (instruments and approaches include green bonds, IBRD lending, IDA credits and grants, IFC investments, MIGA guarantees, and others).

The World Bank Group's primary aim is, and will continue to be, to raise standards of living through strong engagement in countries and in supporting reforms to improve the business climate. Financial support should focus on driving growth, raising median incomes, creating jobs, fully integrating women into the economy, addressing environmental issues and supporting stronger and more stable economies, for which the World Bank Group also provides technical assistance and advisory services.

In order to address these many challenges, the Bank's resources should be preserved and targeted towards the poorest members. Cooperation with other multilateral stakeholders should be fostered and strong leadership is needed.

Panel 3: Promoting global public goods to foster inclusive and sustainable development

Moderator. François Bourguignon, Emeritus Professor, Paris School of Economics

Panelists:

Mark Carney, *Governor, Bank of England*
Paul Collier, *Professor of Economics and Public Policy, Blavatnik School of Government, Oxford University*
Ricardo Fuentes-Nieva*, Executive Director, Oxfam Mexico*
Ngozi Okonjo-Iweala*, Former Finance Minister of Nigeria, Former Managing Director of the World Bank and co-Chair, Global Commission on the Economy and Climate*

The expression "Global public good" does not appear in the original Bretton Woods deliberations. Yet open markets can thrive under multilateralism in terms of trade, and development is dependent on international financing. And both open markets and development have a role to play to produce prosperity. With respect to development goals, there have been multiple successes, related to the reduction in poverty, improved health, and education. Threats have appeared however, including financial instability, concerns about trade and development, sustainability and inclusiveness. Sustainability issues in particular pertain to financial stability, environmental and notably climate issues. And climate change aggravates development issues due to the damage caused by natural disasters, with poor countries often in the front line. The persistence of under development complicates the management of global public goods as it requires transfers to help poorer countries. Inclusiveness at the global level is needed to ensure that some countries are not left behind. Catching up took place in the past, but it may not continue. Demographic trends may make it difficult to keep up growth, and "global public bads" could surface. Lack of inclusiveness at the domestic level may also have an impact at the global level via political disruptions and inequalities. Acceleration of growth sometimes does not lead to poverty reduction.

Resilience today requires a climate change perspective at the global level, as well as taking due account of imbalances in wealth and income, demography and sovereignty. While it is not the responsibility of the monetary and regulatory authorities to drive the transition related to climate change and sustainable development, they can amplify the effects of good climate policies, in collaboration with market participants. The central banks' mandate includes responsibility for financial stability, the insurance sector and reinsurance. Management of risks, notably transitions risks, is very important. The action of regulatory and supervisory authorities toward the private sector is centered on a "3 Rs" strategy: Reporting, Risk-management, and Return (profitability). Following a G20 initiative, the reporting agenda is driven by the FSB and its Task Force on Climate-related Disclosure (TFCD) which is already gaining moment. It is only a matter of time until disclosure of climate-related risks becomes mandatory. Risk-management is about the analysis of strategic resilience of firms to different climate outcomes. Groups such as the Network for Greening of the Financial System (NGFS - gathering financial regulators covering about 50% of global emissions) are helping coordinate this work and share information. The network is highly engaged, with a focused work plan around scenario analysis and stress testing of financial firms. There is evidence that ESG (environment, social and governance) investments generate excess return. The required infrastructure investments for the transition to a net zero economy will rest largely on mainstream finance.

In developing countries, climate change and development go hand in hand. While African countries are responsible for only 3% of carbon emissions, the extreme weather condition in the continent this year has wiped out years of economic development in some countries. In this context, these countries should i) invest in resilient infrastructures and foster "good" incentives, including carbon prices, ii) develop climate efficient cities and low carbon resilient economies, and 3) develop land and forest protections. This will require important financial support that can only be met via the participation of multiple stakeholders. In this respect, initiatives such as country platforms, which aim at bringing together public and private creditors, should be encouraged.

Beyond climate, developing countries - particularly in Africa - are faced with an overall difficult environment that prevents them from catching up with other economies. In light of the Asian experience, global policies could push towards the emergence of country success stories based on star businesses that would pave the way for other businesses/countries to become as successful. The transition of fragile states should especially be accelerated. This implies improving the business environment in order for the private sector to generate employment. This also requires adequate borrowing arrangements aimed towards investment in productive and quality infrastructures. Finally, it requires deep trust in leaders implementing sound policies as well as a solid "social contract". A determinant of the latter lies in the state capacities to develop accepted social programs and set fair and efficient tax systems. Development priorities also include education, skills and technology ownership.

Environment crises put pressures on political and social systems. State capacity is needed to strengthen the social contract at the national level in matters related to the environment. There is a need to focus on capacity building, to strengthen taxation and tax systems for domestic resource mobilization, and the possibility for citizens to hold politicians to account. Accountability is important, as is the rule of law.

David Lipton, Acting Managing Director, International Monetary Fund, Keynote Speech

In his keynote speech, David Lipton recalled how the Bretton Woods institutions--and particularly the IMF--have continuously adapted to changing circumstances and challenges over the years. He underlined the IMF's commitment to pursuing economic and financial stability in a multilateral and rules-based setting. He highlighted two key threats and opportunities. First, the shift of economic and financial power from advanced to emerging market economies will have major implications for global trade and capital flows. Consequently, the role of the IMF as a global convener and trusted advisor will be very important. Second, technological change will transform economies, offering new opportunities to accelerate productivity and lift incomes, but bringing also policy challenges (including the structural changes that will create some jobs while displacing others). Innovations in financial services offer the potential to significantly increase efficiency, transparency, and inclusion, but there are also risks, such as cyber threats. Digital currencies are still evolving, and regulators need to facilitate an environment that both fosters innovation and ensures financial stability. In conclusion, David Lipton stressed that new threats to multilateralism, including inequality and climate change, will test whether the Bretton Woods institutions can remain relevant; he believes they can if actions are taken cooperatively and in pursuit of the goals of stability, prosperity, and peace.

Panel 4: An international monetary system for the 21st century

Moderator: Gillian Tett, Chairman Editorial Board and Editor-at-large, US, Financial Times

Panelists:

Carmen Reinhart, *Minos A. Zombanakis Professor of the International Financial System, Harvard Kennedy School*
Tharman Shanmugaratnam*, Senior Minister, Singapore; Chairman of the Group of Thirty*
Jean-Claude Trichet, *Former President, European Central Bank*
Ernesto Zedillo*, Former President, Mexico; Director, Yale Center for the Study of Globalization*

In a new environment characterized by a shift of economic and geopolitical power, a rise of populism and protectionism, and a surge of digital technology, there is an urgency to create a new form of multilateralism. We are well behind in our plan to reach the Sustainable Development Goals. There is a sense of urgency regarding a number of issues including climate change, achieving growth and job creation, and convergence. The new multilateralism should be less centralized and work more as a network system based on the convergence of key interests, and on principles and incentives for collective actions instead of binding rules. Incentives for collective actions could take the form of systems of pledges, with a need for transparency, monitoring reviews and discipline. To work well for global prosperity, the digital era needs proper norms and proper incentives. For example, the issue of data localization could be tackled through data connectivity agreements between countries.

Financial stability remains one of the key challenges of globalization and a key field of experiment for multilateralism. Herding behaviour in financial markets are disruptive and lead countries to engage in actions that impair growth. Macroprudential policies and capital flow management measures are key tools to exploit. The approach towards capital flows should set economic growth as the primary objective, which will necessitate new norms in the mix of monetary, fiscal and structural policies.

The international monetary system is currently overly dependent on the US dollar. The dollar is the *de facto* global reserve currency and its anchoring role has increased compared to the Bretton Woods era. It is the dominant currency in which countries issue debt or trade. The U.S. is running twin deficits (fiscal and current account), almost non-stop since the 1980s, and external indebtedness is currently at high levels, as an illustration of the Triffin dilemma. Debt to GDP cannot rise forever, and the U.S. size in terms of global GDP has been shrinking. This hegemony is linked to the demand for safe assets. The general perception that at lower interest rates a country can accumulate more debt has to be balanced by the fact that rates will not be low forever. But in the near future, the dollar will certainly remain the reference currency and U.S. debt the main safe asset to the extent that the euro debt market remains fragmented and the convertibility of the renminbi is restricted. The most liquid debt market is the U.S. market. In this context, increased cooperation between countries is needed to address the challenges associated with capital flows and exchange rate volatility. In the medium term, the development of the Special Drawing Rights (SDR) could be an alternative and constitute a store of value. The recent inclusion of the renminbi in the basket of reference currencies for the SDR and the strong anchor provided by the similar inflation targets in the main advanced economies make this instrument more appealing. A push to develop its official and private use would be necessary for a larger role.

The role of China as a new major lender may shape the nature of capital flows in the years to come. The recent rise of opaque and unrecorded official lending by new creditors poses challenges for global surveillance and for the efficient functioning of markets in terms of financial stability and sustainability. These powerhouses of official lending will need to be integrated into the system for accurate surveillance purposes and market pricing.

Criticism towards globalization may weaken the willingness of nations to engage in multilateralism. While the fear of globalization needs to be addressed, the share of responsibilities between the shortcomings of globalization and that of national policies need to be balanced. Countries which were the most exposed to globalization and technology have fared well in comparison to other countries. Domestic policy actions can provide the right safeguards, along with accountability. Insufficient or inadequate social policies, tax reforms, spending on health care and other political considerations are more at fault than globalization itself. Given the current state of play, the issue is not about going back to the original Bretton Woods, but resisting the danger of a reverse Bretton Woods moment. We believe in the benefits of globalization, but there is an urgent need to broaden our agenda to social inclusiveness and fairness, digitalization and climate change.

Concluding remarks

Michel Camdessus, Former Managing Director, International Monetary Fund, echoed the call for a new multilateralism and underlined the need for an international monetary and financial system adapted to the new circumstances. The most effective way to protect national interests is through international cooperation, and efforts to attain common rules. Now and for the next 75 years, there is a need to be even more committed to a safer system, new modalities of cooperation, sustainable development and putting in place an adequate monetary system. There are concerns about the speed of changes and innovations. The future crisis will be of a different nature: there is a need to reflect on the reliability and the reactivity of existing methods and tools (e.g. SDR allocations, central bank swaps network). Central banks have a key role to play in developing modalities for financial cooperation. Echoing the Eminent Persons' Group proposals, Mr. Camdessus encouraged International Financing Institutions to develop platforms and risk mitigating tools in order to catalyze private investment in low-income countries. Several reforms could facilitate the emergence of a new system: the adaptation of IMF quotas, the recognition of its status of international lender of last resort, diversification of reserves, and the development of stabilization instruments to supplement international reserves in the spirit of the SDR.

Minister Bruno Le Maire

Key successes of the past decades include: prosperity, more trade, more jobs, more growth, reduced poverty, peace, but how to reinvent a multilateral order, especially in times of trade tensions? Commitment to cooperation is an invaluable asset.

There are many challenges today. Inequalities among nations and within countries are increasing and are a threat to stability. Natural resources are running out. There is a need to find global answers to these challenges and the Bretton Woods order as it stands has reached its limits. There is a need for a strong commitment to work towards compromises. The rise of China has led to the building of a new order, via the Belt and Road initiative which could be seen as a Chinese Bretton Woods. This initiative needs to be based on reciprocity. There is a need to pave the way for a new order, with a level playing field and re-foundation of capitalism.

Citizens are rejecting a form of capitalism based on short-term profits, and inequalities. Climate change and the environment are key issues of the new generations. The best lever to fight climate change is finance, via investments in green technology. The new order must be built on cooperation, not on protectionism that leads to conflicts. WTO reforms are a priority – there is no free trade without an arbitrator. Laissez faire is not acceptable: we need an operational WTO. The digital economy calls for appropriate regulation. The new Bretton Woods order requires strong decisions to address climate change, inequalities and financial stability issues.