From Great Depression to Great Recession

The Elusive Quest for International Policy Cooperation

Editors

ATISH R. GHOSH and MAHVASH S. QURESHI
Note to Readers

This is an excerpt of From Great Depression to Great Recession: The Quest for International Policy Cooperation edited by Atish R. Ghosh and Mahvash S. Qureshi.

Analyzing current issues through the prism of history can be instructive. The global financial crisis and the ensuing Great Recession raised concerns about adjustment fatigue, deflation, currency wars, and secular stagnation that presented a sense of déjà vu: similar concerns had arisen at the time of the Great Depression and at the end of World War II. As with earlier crises, these concerns prompted calls for greater international policy cooperation. This volume gathers papers by eminent scholars to discuss how history can inform current debates about the functioning and challenges of the international monetary system. An introductory chapter sets the stage for the other chapters in the volume by giving a broad overview of the performance of the international monetary system over the past century, highlighting the key events and challenges that shaped it. Subsequent sections look at historical antecedents of today’s challenges, describe how the modern international monetary system has been—and continues to be—shaped through international financial diplomacy, provide a present-day perspective, and examine international policy coordination.

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From Great Depression to Great Recession: The Quest for International Policy Cooperation
Edited by Atish R. Ghosh and Mahvash S. Qureshi
ISBN: 978-1-51351-427-7
Pub. Date: April 2017
Format: Digital; Paperback, 6x9 in., pp.229
Price: US$27.00

For additional information on this book, please contact:
International Monetary Fund, IMF Publications
P.O. Box 92780, Washington, DC 20090, U.S.A.
Tel: (202) 623-7430 • Fax: (202) 623-7201
Email: publications@imf.org
www.bookstore.imf.org
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In 2014, we celebrated the 70th anniversary of the Bretton Woods Conference; 2015 marked the 40th anniversary of the IMF’s Second Amendment to the Articles of Agreement and the 30th anniversary of the Plaza Accord—one of the few instances of explicit international policy coordination. Against the backdrop of the world economy still limping out of the global financial crisis, these events provided the impetus for us to convene a symposium, From Great Depression to Great Recession: The Elusive Quest for International Policy Cooperation, at IMF headquarters in January 2015, with the aim of seeking insights from history about how to tackle present-day problems in international monetary relations.

The parallels with history are striking. During the interwar period, for instance, deficit countries struggled to correct imbalances under the fixed exchange rates of the gold standard; there was an asymmetric burden of adjustment between deficit and surplus countries; and all countries, including those with surpluses, were reluctant to engage in fiscal expansion. The analogy may be inexact, but many of the same concerns are echoed in the European headlines of today. More disturbing is the parallel to the 1930s in the rise in populism, nationalism, and extremism—bred of unemployment, economic frustration, and social tension: the legacy of financial crisis.

The phrase “secular stagnation” was coined by Harvard economics professor Alvin Hansen in 1938; Larry Summers used it again in 2014 at the IMF’s Fifteenth Jacques Polak Annual Research Conference. Nor are “currency wars,” a coinage we hear all too often today, a new phenomenon—the interwar period was characterized by a disastrous combination of competitive devaluations, exchange restrictions, and trade barriers.

In addition, the 1930s saw a scramble for gold reserves, which imparted a huge deflationary bias to the world economy that was especially damaging to debtors. Today, the scramble may be less global, but emerging market economies have been relentless in accumulating reserves—partly to keep their currencies competitive in the face of current or capital account surpluses, partly as insurance against the volatility of private capital flows. Again, this trend may be imparting a deflationary bias at a time when the global economy can least afford it.

I believe these parallels—and there are plenty more—are not coincidental. They arise because the core challenges of the international monetary system are constant: (1) helping countries adjust without resorting to measures “destructive of national or international prosperity”; (2) promoting an equitable burden of adjustment between surplus and deficit countries; and (3) ensuring sufficient global liquidity—by which I mean the ability of solvent countries to finance deficits even during times of stress.

Though manifested in different ways, these challenges were present in the interwar period; they were present during the Bretton Woods years; they were
present post–Bretton Woods; and they are surely with us today—indeed amplified by the growth in private capital flows, and rising global interconnectedness. That is why I believe that analyzing current issues through the prism of history can be instructive.

So what are the current issues with the international monetary system? Let me mention three—not necessarily with the expectation of getting immediate answers, but in the hope that they will foster discussion and debate.

The first, alluded to above, is the scramble for international reserves (and the underlying causes thereof). In 2007, emerging market economies held US$3.5 trillion reserves; as of the end of 2014, that has nearly doubled to US$6.6 trillion. There are various reasons to worry about this, but what is the solution? Should these countries be more symmetric in their foreign exchange intervention? Should they try to insulate themselves from volatile capital flows? Is this the time to fundamentally rethink the role of finance in national economies, and of cross-border banking flows in the world economy? How do we create credible alternatives to reserves accumulation for countries concerned about current or capital account shocks? What role can IMF contingent facilities such as the Flexible Credit Line (FCL) and Special Drawing Rights (SDRs) play? And do we need to revive ideas of sovereign bankruptcy mechanisms, and the interplay between official and private creditors?

The second issue is the risk of secular stagnation—a prolonged period of slow growth of the world economy because of low investment and deficient demand. Despite some positive signs in the US economy, and lower oil prices, the news from the rest of the world is far from reassuring. How can the global economy pull itself up by its bootstraps? Is this a time for paying down public debt? Or for embarking on much-needed public infrastructure investments? What role can emerging markets, including China, play in acting as a locomotive for the world economy without jeopardizing their own financial stability?

The third concern is that a world of secular stagnation will become a world of currency wars. With monetary policy at its limits, and fiscal policy hobbled by high debt and political constraints, it becomes very tempting to boost aggregate demand through currency depreciation. Personally, I do not believe the world is engaged in currency wars yet, but as a multilateral institution, we at the IMF need to consider very carefully how we think of foreign exchange intervention versus (conventional or unconventional) monetary policy when the impact on the exchange rate and capital flows—and hence on trading partners—may be much the same. Indeed, one may well ask whether, in a world of floating exchange rates, there is any meaningful distinction between monetary and exchange rate policies. Do we need to consider spillovers through the capital account as rigorously as those through the current account? More broadly, should we devise some mechanism for ensuring more equitable burdens of adjustment between surplus and deficit countries?

All this brings me to the issue of international policy coordination. The irony about coordination is the unanimity on the subject. Economists are unanimous that, provided there are fewer instruments than targets (which is surely the case
these days), coordination will be beneficial; policymakers are equally unanimous that, whatever the merits of others coordinating, they themselves want no part of it. Why is this? Is it simply a lack of understanding that coordination is not about doing your neighbor a favor—it is about self-interested, but mutually beneficial, trades of policies? Or do the obstacles run deeper? And if so, what can be done about it?

Is there a useful role for some type of “neutral assessor” that can identify mutually beneficial coordinated packages and, most importantly, provide unbiased analysis of transmission effects? Without presuming to take on this role, the IMF has in recent years been increasing its analytical work on cross-border spillovers. An alternative, although potentially complementary, approach is to try to devise “rules of the road”—akin to those under Bretton Woods. Perhaps building on the IMF’s Integrated Surveillance Decision, we can think of rules that circumscribe policies that have significant adverse spillovers through either the current account (currency manipulation; unfair trade practices) or the capital account (volatile capital flows). A related question is whether we need to devise some rules of the road concerning spillovers of what are usually termed domestic policies (monetary and fiscal policies) paralleling the Articles’ strictures against exchange rate manipulation.

Whatever the approach, we need to find solutions. As Harry Dexter White, one of the principal architects of Bretton Woods, argued: “rich and powerful countries can safely and easily ignore the interests of poorer or weaker neighbors or competitors for long periods of time, but by doing so they imperil the future and reduce the potentiality of their own level of prosperity.” The lesson, he concluded, is that “prosperous neighbors are the best neighbors; that a higher standard of living in one country begets higher standards in others; and that a high level of trade and business is most easily attained when generously and widely shared.”

What has changed in the intervening 70 years is the composition of the “rich and powerful countries.” At Bretton Woods, it was basically the United States and the United Kingdom; by Plaza, it was the G7; now with the rising importance of emerging market economies, we are talking G20. Today, more than ever, we need multilateralism. The IMF quota increase that a supermajority of the membership recently approved, and that recognizes the reality of the dynamics of the world economy, is a crucial accomplishment: we need to build on it with bold, innovative thinking to strengthen the international monetary system.

In closing the Bretton Woods Conference, US Secretary of the Treasury Henry Morgenthau remarked that, while the monetary agreement may seem mysterious and obscure to the general public, it lay at the most elementary “bread-and-butter realities” of their daily lives, and constituted a first step through which “the nations of the world will be able to help one another in economic development to their mutual advantage and for the enrichment of all.”

The issues presented and discussed at the symposium by a distinguished group of historians, academics, and former policymakers lie at the very heart of the IMF’s mandate. Perhaps more importantly, they also define the bread-and-butter
realities of the lives of billions around the world. This collection of papers from that symposium extends the exchange of insights and perspectives—including on some of the issues I have raised here—and provides new grist for analysis and debate. I would like to extend my thanks to the contributors to this volume for sharing their expertise and views in drawing lessons from history for today’s problems confronting the international monetary system.

David Lipton
First Deputy Managing Director, IMF
Preface

This volume is a collection of papers presented at a symposium on the history, functioning, and challenges of the international monetary system, organized by the IMF at its headquarters in Washington, DC, on January 23, 2015. The symposium, titled From Great Depression to Great Recession: The Elusive Quest for International Policy Cooperation, brought together eminent scholars and policymakers who provided valuable insights into the origins and evolution of the present-day international monetary system, debated its performance, and exchanged views on the need for reform, and the prospects for international policy cooperation going forward.

The volume is divided into four parts—each corresponding to a session of the symposium, and including chapters that are based on the presentations made in that particular session. In addition, the first chapter provides a broad overview of the international monetary system over the past century, discussing the major events and challenges that shaped it, while the final chapter summarizes the key takeaways from the discussions during the symposium on fostering international policy cooperation. It must be reiterated, however, that the views expressed in this volume are those of the individual authors and do not necessarily represent those of the institutions with which they are affiliated.

Both the symposium and this volume were made possible because of the hard work of many people to whom we owe a debt of gratitude. Our special thanks to Chifundo Moya for his relentless and invaluable assistance in organizing the symposium, as well as in the publication of this volume; to Eun Sun Jang and colleagues in the IMF’s Multimedia Services and Corporate Services and Facilities Department for assistance with the symposium logistics; to Joanne Creary, Michael Harrup, Patricia Loo, and Rumit Pancholi for their diligent and skillful assistance in the publication of this volume; and to all the contributors for enthusiastically participating in the symposium and enriching the discussions, and for patiently cooperating in the production of this volume.

Atish R. Ghosh
Mahvash S. Qureshi
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## Abbreviations

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<tr>
<td>BIS</td>
<td>Bank for International Settlements</td>
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<tr>
<td>BRICS</td>
<td>Brazil, Russia, India, China, and South Africa</td>
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<tr>
<td>CAC</td>
<td>collective action clause</td>
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<td>CRA</td>
<td>Contingent Reserve Arrangement</td>
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<td>ECB</td>
<td>European Central Bank</td>
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<td>EEC</td>
<td>European Economic Community</td>
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<td>EMS</td>
<td>European Monetary System</td>
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<td>ERM</td>
<td>Exchange Rate Mechanism</td>
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<td>EU</td>
<td>European Union</td>
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<td>FCL</td>
<td>Flexible Credit Line</td>
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<td>G5</td>
<td>Group of Five</td>
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<td>G7</td>
<td>Group of Seven</td>
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<td>G10</td>
<td>Group of Ten</td>
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<td>G20</td>
<td>Group of Twenty</td>
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<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
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<tr>
<td>LSAP</td>
<td>large-scale asset purchase</td>
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<td>OCA</td>
<td>optimum currency area</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>OPEC</td>
<td>Organization of the Petroleum Exporting Countries</td>
</tr>
<tr>
<td>QE</td>
<td>quantitative easing</td>
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<tr>
<td>SDR</td>
<td>Special Drawing Right</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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**Alexander K. Swoboda** is a Professor of International Economics Emeritus and former Director of the Graduate Institute of International and Development Studies, Geneva. The Founding Director of the International Center for Monetary and Banking Studies, his academic appointments have included the University of Geneva, the University of Chicago’s Graduate School of Business, the London School of Economics, the University of Lausanne, and Harvard University. He was a Senior Policy Advisor in the Research Department of the IMF (1998–2000) and member of the Council of the Swiss National Bank (1997–2009). He has published widely on international monetary, macroeconomic, and financial issues and holds a PhD from Yale University.

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**Paul A. Volcker** worked in the US federal government for nearly 30 years, culminating in two terms as Chairman of the Board of Governors of the Federal Reserve System from 1979 to 1987. For 10 years, he served as Chairman of Wolfensohn & Co. and as Professor Emeritus of International Economic Policy at Princeton University. He has chaired a committee to determine existing assets in Swiss banks of victims of Nazi persecution, served as Chairman of the Board of Trustees of the International Accounting Standards Committee, chaired an
inquiry into the United Nations Oil-for-Food Programme, and chaired a panel of experts to review the operations of the Department of Institutional Integrity of the World Bank. From 2008 to 2011 he served as Chairman of the President’s Economic Recovery Advisory Board. Educated at Princeton University, Harvard University, and the London School of Economics, he launched the Volcker Alliance in 2013 to address the challenge of effective execution of public policies and to help rebuild trust in government.
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CHAPTER 1

From Great Depression to Great Recession: An Overview

Atish R. Ghosh and Mahvash S. Qureshi

The global financial crisis and the ensuing Great Recession raised concerns about adjustment fatigue, deflation, currency wars, and secular stagnation that presented a sense of déjà vu: similar concerns had been raised at the time of the Great Depression and at the end of World War II. As with earlier crises, these concerns prompted calls for greater international policy cooperation and “rules of the game”—both to achieve a sustainable recovery from the crisis and to prevent future crisis as well. Against this background, in early 2015 the IMF convened a symposium of eminent scholars to discuss how history can inform current debates about the functioning and challenges of the international monetary system. Accordingly, the papers presented at the symposium—compiled in this volume—brought together historical and present-day perspectives on the problems of the international monetary system, insights on the origin and evolution of the current international monetary system, and views on the prospects for a more cooperative system in the future.

This introductory chapter sets the stage for the other chapters in this volume by giving a broad overview of the performance of the international monetary system over the past century, highlighting the key events and challenges that shaped it. The underlying premise of this chapter—indeed, of the entire volume—is that, although the world has experienced profound economic, social, and technological changes during this period, the core challenges to the international monetary system remain largely the same. What are these challenges? First, allowing countries with current account deficits to adjust to payments imbalances without—to put it in the parlance of the IMF’s Articles of Agreement—“resorting to measures destructive of national or international prosperity”; second, ensuring an equitable burden of adjustment between surplus and deficit countries; and third, regulating global liquidity to promote the (noninflationary) growth of world trade and incomes. Although the context in which these challenges have manifested has obviously evolved—not least with the rise of private cross-border capital flows—they retain sufficient commonality over time to allow us to look
into the experience of the past to get valuable insights for the problems of the present.¹

The remainder of this chapter is organized into three sections: the next section provides a historical overview that recalls the performance of the world economy during the late nineteenth century and describes the main events during the interwar period and how these shaped the discussions at Bretton Woods that gave rise to the IMF. It also examines the challenges to the international monetary system in the Bretton Woods era, the advent of floating exchange rates, and the experiments in international policy coordination, before finally turning to the years before the global financial crisis, when the world economy was booming and the IMF seemed to be in the doldrums. The following section draws some parallels between the challenges of the past and issues of the present. The final section presents a brief summary of the chapters that follow.

A SNAPSHOT OF HISTORY
The Gold Standard

The latter part of the nineteenth century and the first decades of the twentieth are often called the golden era of globalization—and with good reason. During these years, world trade grew at an average rate of 6 percent per year, and the major capital exporters—France, Germany, and Great Britain—lent as much as 5 percent to 10 percent of their GDP each year, mainly in the form of long-term capital, to the developing and emerging market economies of the day (Figure 1.1). Expansion of international trade and investment, in turn, helped fuel historically unprecedented increases in output and living standards (Figure 1.2, panel 1).

Underpinning these cross-border movements were major technological advances in transport (railways, shipping, refrigeration) and communications (telegraph, telephone)—together with the gold standard, which provided long-term exchange rate stability and eliminated currency risk. According to Hume’s price-specie flow mechanism, payments imbalances under a gold standard are self-adjusting: in surplus countries, unsterilized inflows (from the current or capital account) expand the money supply, raising prices and eroding competitiveness, thus serving to narrow

¹The rise of cross-border capital flows has transformed the challenges facing the international monetary system in two key ways. First, although net capital flows contribute to global liquidity—financing countries with current account deficits—they also increase the need for country insurance and the public provision of liquidity because, in times of stress, far from being a source of financing, capital flows force deficit countries to run even larger surpluses. In this respect, gross flows (more precisely, the gross stock of liabilities into which they accumulate) may result in balance sheet vulnerabilities whose unwinding generally precipitates net capital outflows. This implies an intersection between the international monetary system, which is mainly concerned with net flows, and the global financial system, which is predominantly concerned with gross positions. Second, gross flows break the link between surplus and capital-source countries, and deficit and capital-recipient countries (for example, the United States is a deficit country but has been a source of large capital flows in recent years, whereas the converse has been true for China). For this reason, it is perhaps now more appropriate to view the challenges of the international monetary system in terms of deficit and capital-recipient (and surplus and capital-source) countries separately.
Figure 1.1. Net Capital Flows, 1880–1913
(Percent of GDP)

1. Net Capital Exports

2. Net Capital Imports

Sources: Authors’ estimates based on Bloomfield 1968 and International Historical Statistics.

Figure 1.2. G7: Macroeconomic Performance, 1880–1913

1. Real GDP per Capita
(1990 international Geary–Khamis dollars)

2. Inflation, Income, and Exports
(Percent)

Sources: New Maddison Project Database (Bolt and van Zanden 2014) for real GDP per capita; Bordo 1993 for inflation and real GDP per capita growth; and UNSTATS for nominal export growth.

Note: Mean growth rate for inflation and real GDP per capita in panel 2 is calculated as the time coefficient from a regression of the natural logarithm of the variable on a constant and a time trend. Export growth is computed over 1900–13.
the surplus; in deficit countries, the opposite happens. Although it is doubtful that the gold standard of that time functioned exactly like this in practice, there is evidence that at least the core central banks (most notably, the Bank of England) generally played by the “rules of the game” instead of trying to vitiate the adjustment process by sterilizing inflows and outflows. Moreover, with central banks mostly focused on maintaining the exchange rate parity, the system enjoyed a high degree of credibility that, in turn, resulted in largely stabilizing short-term capital flows. This is not to imply that capital flows were not volatile: as shown in Figure 1.1, amid various panics and crises (together with developments in source countries), there were large fluctuations even in long-term capital flows. Nevertheless, it seems plausible that the stability of the international monetary system—in the form of the gold standard—contributed both to the resilience of the world economy and to its impressive performance over this period (Figure 1.2, panel 2).

The Interwar Period

During World War I, normal trade and capital flows among the major world economies largely ceased, and the gold standard was suspended de facto. Following the cessation of hostilities, it was natural that private and central bankers of the leading nations (with the notable exception of the Soviet Union) should seek to restore the liberal—and for the great banking houses, highly profitable—pre–World War I international monetary order. As the 1922 Genoa Economic and Monetary Conference, held to discuss and resolve the problems in the postwar economic and financial reconstruction of Europe, resolved, “all artificial control of exchange … is futile and mischievous and should be abolished at the earliest possible date.”

Wartime dislocation, currency misalignments, and deficit financing of reparations and reconstruction costs delayed this process, especially in Europe. But
starting with the 1924 Dawes Plan and associated Dawes Loan (publicly endorsed but privately funded), Germany managed to stabilize its economy and put its new currency, the Reichsmark, on the gold standard. Britain returned to gold in 1925 at its prewar parity. France also de facto returned to gold in 1926 (de jure in 1928), albeit at a much depreciated exchange rate. By the late 1920s, most of the world’s major economies were back on the gold standard.

Buoyed by the success of the Dawes Loan, and with the gold (exchange) standard reestablished, American banks entered a period of massive private international lending, averaging a billion dollars a year over 1924–29, half of which was destined for Europe, partly intermediated by British banks. Town halls in Germany were said to be inundated by representatives of international banks offering aggressively priced credits, spurring a huge economic and financial boom.7

This stability, however, proved short-lived. To effect the real transfer of resources required by its war reparations, Germany needed to generate a current account surplus, whereas the recipients of the reparations needed to generate a corresponding deficit (this phenomenon was termed the “transfer problem” by John Maynard Keynes). But surplus countries—most notably France and the United States—did not want to run current account deficits, and there was no mechanism to prevent them vitiating the adjustment process by sterilizing the inflows of reserves.8 The Dawes Loan and other credits to Europe had not thus solved the underlying adjustment problem, whereby creditor nations were unwilling to increase imports to allow debtor countries to service their debts, it had merely postponed it.

When a boom in the New York Stock Exchange (which ultimately ended spectacularly in the October 1929 crash) drew both domestic and foreign capital to the United States, Europe suffered an equally massive sudden stop.9 Unable to obtain fresh credits to meet her short-term obligations, in July 1931, Germany declared a standstill on foreign payments and imposed exchange restrictions. With London banks known to be heavily exposed to Germany and central Europe, this triggered a run on the pound sterling, which was forced off gold in September 1931. Because the pound sterling had been considered a reserve currency, the immediate impact of its devaluation was a loss of confidence in the gold exchange standard: central banks that had been holding reserves in the form of US dollar assets rushed to convert them into gold, in turn putting pressure on the dollar (which eventually devalued in July 1933).

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7See Brown 1987 and Eichengreen 1992 for a detailed account of that period. During 1925–29, European output grew at 31 percent (compared with 20 percent of world output growth), while the demand for US machine tools rose by 87 percent (League of Nations 1932).

8The combination of having pegged at an undervalued exchange rate and insistence that the foreign currencies it received be converted into gold meant that the Banque de France’s gold stock rose from 7 percent of central banks’ total in 1926 to 27 percent by 1932.

9In Chapter 2, Harold James recounts how this cessation of credits revealed the precarious state of overleveraged central and eastern European banks, resulting in a cascade of financial crises.
What ensued was a decade of almost dizzying capital flight and hot money flows. As each country scrambled to build up its gold reserves, the world trade and payments system imploded in a morass of competitive devaluations, exchange restrictions, capital controls, and trade barriers. Exacerbating the decline in world output was that surplus countries responded to the downturn by fiscal tightening—as “prudent” budgetary policy of the time dictated—which not only made the external adjustment of deficit countries more difficult (requiring them to pursue even more contractionary policies than otherwise would have been necessary), it also dealt a deflationary blow to the world economy. Falling prices led to a higher real value of all nominal debts, further exacerbating the decline in aggregate demand, and transmitting the shock to the emerging market and developing countries through collapsing commodity prices (Figure 1.3, panel 1). Unemployment soared (reaching 25 percent in the United States; Figure 1.3, panel 2), and in many countries, the decline in output during the Great Depression was greater than it had been during World War I (Figure 1.4, panel 1).

Although it is difficult to disentangle the contribution of the resulting collapse of world trade (Figure 1.4, panel 2)—and hence of the failures of the international monetary system—to the collapse of world output during the Great Depression, it is noteworthy that as early as 1928, Gustav Cassel warned:

The absolute necessity of international cooperation on broad lines for the stabilization of the value of gold is most clearly seen if we reflect on the alternative to such cooperation. This would obviously be a general and ruthless competition for gold, a consequent continual rise in the value of gold [and a decline in the price of all other goods], and a corresponding, world-wide economic depression for an unlimited future. A very disagreeable consequence…would be a general aggravation of all debts contracted in a gold standard, doubtless in many cases followed by an incapacity to pay debts or a refusal to do so (Cassel 1928, 98–99, cited in Irwin 2014).

Accordingly, it seems likely that failures of the international monetary system played no small role in turning a financial panic into a global Great Depression.

**Bretton Woods**

The interwar period amply demonstrated the three core challenges of the international monetary system: deficit countries, unable to obtain financing, resorted to a plethora of restrictive practices; surplus countries, unwilling to share the burden of adjustment, forced deficit countries to pursue even more contractionary policies; and the scramble for reserves against a limited supply of gold imparted a deflationary bias to the world economy.

Recognizing this, Keynes—who represented Great Britain at Bretton Woods in 1944—proposed to construct a new international monetary order that included substantial financing for countries with temporary balance of payments deficits, symmetric penalties on deficit and surplus countries alike, and a mechanism for controlling global liquidity with the creation (and revaluation) of a global currency, bancor. By contrast, the other main protagonist at Bretton Woods,
Harry Dexter White of the US Treasury, proposed a much smaller IMF that would allocate resources selectively to member countries on demand. He opposed Keynes's ideas for an equitable burden of adjustment between surplus and deficit countries and the creation of bancor (instead, White favored lending national currencies; Boughton 2002).
Much has been made of the differences between Keynes and White, but in reality, these were probably less intellectual debates than the prosaic fact that one was representing a major debtor country, which expected to run continued deficits, and the other represented the world’s largest creditor country, which expected to run surpluses for the foreseeable future. In the event, White prevailed: the IMF had significantly fewer resources than Keynes wanted, surplus countries would face no penalty for failing to adjust,
and there would be no bancor—the US dollar would be the sole substitute for gold.\textsuperscript{10}

One issue that the two men did agree on was the need for structural capital controls (preferably enforced at both the source and recipient ends). This would allow governments to pursue the full employment policies increasingly expected by the electorate, while maintaining fixed exchange rates and avoiding competitive devaluations (in essence, capital account restrictions would resolve the “trilemma” of fixed exchange rates, an independent monetary policy, and free capital mobility). More generally, the experience of the interwar period had convinced both Keynes and White that free capital mobility and free trade were incompatible: destabilizing capital flows would spur protectionist measures—and given the choice, they preferred current account over capital account convertibility.\textsuperscript{11}

During its initial years, the IMF lent little. Most developing countries, having supplied vital primary products during the war, had emerged from it with plentiful foreign exchange reserves, and as a matter of policy, the IMF did not lend to European countries that were recipients of Marshall Aid. But by the mid-1950s, as the membership expanded (Figure 1.5), so did the calls for financial support, and the IMF began fulfilling one of its core functions of assisting members facing balance of payments difficulties. More than 30 advanced and developing economies received IMF support during the 1950s, including programs with France and the United Kingdom in the aftermath of the Suez Crisis; in the following decade, the number of arrangements jumped to 220.

Already, however, stresses had begun to appear in the system. These were related to the failure of Bretton Woods to address the two other challenges of the international monetary system: asymmetry in the burden of adjustment and regulation of the supply of global liquidity. By the early 1960s, continued US balance of payments deficits were turning the postwar “dollar shortage” into a “dollar glut” as US corporations invested heavily in Europe and elsewhere. Unwilling to tighten monetary policy (Figure 1.6), the United States resorted to controls on capital outflows in the form of the Interest Equalization Tax, though this was insufficient to stem capital outflows completely. Moreover, as the decade proceeded, expenditure on the Great Society programs and the Vietnam War worsened the US current account, further contributing to the country’s balance of payments deficit. But having scuppered Keynes’s plan of symmetric penalties, the United States now found it difficult to force Germany, Japan, and other surplus countries to revalue their currencies or to undertake expansionary policies that would narrow their current account surpluses.

\textsuperscript{10}Steil (2013) provides a fascinating account of the battle between Keynes and White. Although the final outcome at Bretton Woods was dominated by White’s plan, and not that of Keynes, ironically among White’s papers, a doggerel apparently scribbled by a member of the British delegation was found: In Washington Lord Halifax / Once whispered to Lord Keynes, / It’s true they have all the money-bags / But we have all the brains (Gardner 1980, cited in Boughton 2002).

\textsuperscript{11}As Helleiner (1994) recounts, powerful New York banking interests succeeded in watering down the provisions in the IMF’s Articles of Agreement for restricting capital mobility; nevertheless, the Articles favor current account convertibility over capital account convertibility.
The second shortcoming of Bretton Woods—the lack of a mechanism to regulate global liquidity—gave rise to what became known as the Triffin dilemma. Global liquidity, in the context of the international monetary system, refers to the ability of (solvent) countries to finance current account deficits, especially in times of stress. The most obvious source of such liquidity is owned foreign exchange reserves, but there are others, such as central bank swap lines or IMF financing. In principle, private capital flows could be another source of global liquidity because they finance current account deficits—but in times of stress (a financial crisis in the country concerned, regional contagion, or disruptions in international capital markets more generally), such financing is likely to dry up, and borrowing countries may face a sudden stop. Worse, as foreign investors (sometimes joined by domestic residents) rush for the exit, they increase the country’s financing needs—requiring it to use more of its reserves or to generate a larger current account surplus. On net, therefore, rising private capital flows—and growing international trade—tend to increase the need for global liquidity.12

12A simple numerical example illustrates why growth of world trade requires increased global liquidity. Suppose a country’s imports and exports are $100 million so that its trade is balanced, but there is the risk that a shock would reduce exports by 10 percent to $90 million. In order not to have to adjust by reducing imports, the country would need to hold $10 million of foreign exchange reserves. Now suppose trade increases to $1 billion; a 10 percent decline in exports would lead to a $900 million trade deficit, and to cushion against such a shock, the country would need to hold $100 million of reserves.
The Triffin dilemma was that, on the one hand, increasing world trade and capital flows meant that countries—and thus the system as a whole—needed the United States to run balance of payments deficits in order to create reserves, but on the other hand, larger deficits meant a shrinking stock of gold with which to redeem the dollars accumulating in the coffers of foreign central banks (Figure 1.7, panel 1). Bretton Woods was predicated on the dollar being “as good as gold” (that is, an immutable value of the dollar in terms of gold), and thus the generation of reserves by the United States meant that its stock of external liabilities increased, which undermined confidence in the system (Figure 1.7, panel 2). To solve this dilemma, the IMF in 1969 created the Special Drawing Right (SDR), an artificial reserve asset that harkened back to Keynes’s bancor. By allocating SDRs to member countries (in proportion to quota), the IMF could create additional global liquidity independently of US

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13The SDR is both an asset and liability to participants in the SDR Department. It is an asset because ownership rights can be enforced (economic benefits are derived by the owners by holding them or using them over a period of time), and it is a store of value. But it also has attributes of a liability because countries are required to pay interest on it, and a country would be required to repay any allocation of SDRs if it left IMF membership (Galicia-Escotto 2005). Because an SDR has the nature of both an asset and a liability, Otmar Emminger (the vice president of the Bundesbank) in the late 1960s likened it to a zebra that might be considered as a black horse with white stripes or a white horse with black stripes (Solomon 1982, 142).
From Great Depression to Great Recession: An Overview

To date, however, there have been only three general allocations: SDR 9.3 billion in 1970–72; SDR 12.1 billion in 1979–81; and SDR 161.2 billion (together with a special allocation of SDR 21.5 billion) in 2009 in the aftermath of the global financial crisis. One reason for the long gap between the 1970s and the 2009 SDR allocations was the belief that the rise in private capital flows, especially to developing and emerging market economies, had obviated the need for additional global liquidity in the form of SDRs.

The SDR solved the Triffin dilemma, but continued US monetary and fiscal expansion in the late 1960s and early 1970s, and its worsening balance of payments, eventually resulted in the collapse of Bretton Woods—despite the deployment of an array of increasingly desperate measures to prop up the system, which included capital controls, swap lines, and moral suasion of key US trading partners. As the US trade balance deteriorated (Figure 1.8, panel 1), anticipation of a devaluation of the dollar led to huge capital outflows, which reached $30 billion by 1971 (Figure 1.8, panel 2). On August 15, 1971, unable to stop this hemorrhage of capital, and frustrated that it could not persuade key surplus countries to revalue their currencies, President Nixon’s administration suspended gold

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14 The IMF can also force countries to hold SDRs as reserves rather than employ them as long-term financing. By canceling SDRs, the IMF can also regulate global liquidity when it is deemed excessive.

convertibility of the dollar, imposed an across-the-board 10 percent import surcharge, and instituted wage-price controls.

Following the “Nixon shock,” a new set of parities was negotiated at the Smithsonian Agreement in December of that year, entailing a devaluation of the dollar of about 10 percent and a new official price of gold of $38 an ounce (though official dollar convertibility into gold was not restored). But this new agreement (which Nixon hailed “the most significant monetary arrangement in the history of the world”) proved short-lived. In February 1973, the dollar was devalued by a further 10 percent—but even that did not suffice. After massive foreign exchange intervention failed to stabilize exchange rates, the price of gold was allowed to reach its free market value (Figure 1.9, panel 1), and the major industrialized economies moved to generalized floating (Figure 1.9, panel 2).

After the collapse of Bretton Woods, in July 1972, the Committee of Twenty—a ministerial body composed of the constituencies represented at the IMF Board—identified two key goals for the reformed international monetary system: “achievement of symmetry in the obligations of all countries debtors and creditors alike,” and “the better management of global liquidity”—precisely the same goals as had occupied Keynes and White at the time of Bretton Woods! Yet, as at Bretton Woods, agreement proved elusive. The 1974 oil price shock, which affected countries differently according to their oil dependence, also made it

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difficult to reestablish fixed parities across the major industrialized countries. Instead, the IMF’s Articles of Agreement were amended to legitimize floating exchange rates. To prevent competitive devaluations or depreciations, the new Article IV called on the IMF to “oversee the international monetary system to ensure its effective operation … [and to] exercise firm surveillance over the

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exchange rate policies of members.” Thus, the term “surveillance” entered into the IMF’s lexicon.17

At one level, Bretton Woods had been characterized by an extraordinary degree of international cooperation. Beyond the system itself, which was designed to avoid the competitive devaluations and beggar-thy-neighbor policies of the interwar period, key officials had cooperated closely—crafting the Gold Pool, central bank swap lines, and both implicit and explicit agreements not to convert dollars into gold—to safeguard and sustain that system. (Of course, the fundamental coordination—surplus countries agreeing to revalue their currencies and the United States pursuing tighter monetary and fiscal policies—was lacking, which is what ultimately led to the demise of the system.) Nevertheless, the system lurched from one crisis to the next, until it finally collapsed—ushering in a period of floating exchange rates that promised smoother adjustment to payments imbalances, and thus fewer crises, both in individual countries and in the system as a whole. Yet, the performance of the world economy—trade expansion, output growth, moderate inflation, and financial (notably, banking) stability—during Bretton Woods not only surpassed that of the gold standard era (Figure 1.10), it has been unparalleled ever since (see Figures 1.11 and 1.13).

Advent of Floating

For the IMF, the collapse of Bretton Woods presented an existential crisis: it seemed hard to justify an institution whose very raison d’être—the Bretton Woods system—had ceased to exist. But the 1974 oil price shock, petrodollar recycling, the buildup of developing country debt, and the subsequent debt crisis meant that, by the 1980s, the IMF was very much back in business, with demand for the use of IMF resources at an all-time high (Figure 1.12).

17 Under Article IV, the IMF conducts bilateral surveillance in the form of consultations with each member country, typically once each year. The origin of these “Article IV consultations” is actually Article XIV, which requires annual consultations (starting five years after the establishment of the IMF) with all countries availing themselves of the transitional arrangements under Article XIV to maintain exchange restrictions. Because, in the early days of the IMF, countries often requested IMF support in the context of removing these restrictions, these consultations formed the basis of, or even substituted for, program discussions. In 1958 the United Kingdom gained Article VIII status (that is, removed exchange restrictions on the making of payments and transfers for current international transactions), but because the authorities were considering seeking IMF support, they voluntarily agreed to continue their annual consultations. When Article IV was amended in 1978, it introduced the obligation of members to consult with the IMF on exchange rate policies “when requested by the Fund,” without specifying an annual cycle. The purpose of this consultation is to check compliance with members’ obligations, in particular not to manipulate its exchange rate. The practice of annual consultations between the IMF and its members thus has a dual-track history—Article XIV via Article V (on conditions for the use of IMF resources), and the amended Article IV. In turn, surveillance serves two—quite distinct—functions: assessing macroeconomic or financial vulnerabilities, especially those that might spill onto the balance of payments and require the IMF’s financial support; and assessing exchange rate policies to ensure that countries are not manipulating their exchange rates or gaining unfair competitive advantage.
On the surveillance side, and in terms of international policy coordination, however, the IMF’s role was limited. Very quickly, it became apparent that floating exchange rates were not a panacea and that the system could still produce large current account imbalances. In particular, as before, there was no means of forcing surplus countries to reflate their economies, and although the loss of
Figure 1.11. Exchange Rate Volatility and Macroeconomic Performance

   (Local currency / US$)

2. Inflation, Income, and Exports, 1881–2013
   (Percent)

Sources: Bordo 1993 for inflation and real per capita growth up to the Bretton Woods period; IMF, World Economic Outlook database, for inflation and nominal export growth over 1974–2013; Reinhart and Rogoff 2009 for crisis data; UNSTATS for nominal export growth up to the Bretton Woods period (data available for 1900–60); and World Bank, World Development Indicators database, for real per capita growth over 1974–2013.

Note: For the gold standard and interwar periods (panel 2), inflation and real per capita mean growth are calculated as the time coefficient from a regression of the natural logarithm of the variable on a constant and a time trend.
financing typically forced adjustment on deficit countries, this did not apply to the United States, for whose assets there was a voracious global demand. The London and Bonn economic summits in 1977 and 1978, respectively, were attempts at addressing these imbalances through explicit policy coordination. In exchange for the United States undertaking to reduce its budget deficit, rein in inflation, and (subsequently) strive for the stability of the US dollar (including through coordinated intervention and the issuance of foreign currency–denominated Carter bonds), Japan and Germany agreed to implement expansionary policies—thus acting as a “locomotive” to the world economy.

The experiment turned out badly: just as Germany and Japan were implementing their fiscal expansion, the 1979 oil price shock dealt the world economy a fresh inflationary blow, and although these countries carried through their commitments, the experience gave policy coordination a bad name.18 Meanwhile, in the United States, continued dollar weakness and high inflation prompted the Federal Reserve under the chairmanship of Paul Volcker to institute extremely tight monetary policies, while the Reagan administration’s tax cuts and defense expenditures provided a significant fiscal impulse. The result was a sharp appreciation of the dollar and a steep rise in world interest rates—both of which increased the debt burden of developing countries. Together with the United States, several other major industrialized countries tightened monetary policy to

18For a detailed discussion, see for example, Putnam and Bayne 1984, 99.
lower inflation—in part by appreciating their currencies. Because exchange rates
cannot simultaneously appreciate against each other, these uncoordinated
attempts to disinflate likely resulted in excessively tight monetary policies, when
the welfare gains to these countries of greater policy coordination would have
been modest, yet measurable (Oudiz and Sachs 1984).

It was not until 1985, when the dollar had clearly reached an unsustainable
peak, that the Group of Five (G5) returned to explicit policy cooperation—
mainly in the form of the September 1985 Plaza Agreement on foreign
exchange intervention. How much effect the Plaza Agreement had on the dollar
has been much debated: the turning point of the dollar was some months ear-
lier, but the signaling effect of the agreement that the nondollar currencies
among the G5 had to appreciate may have had some impact on the markets.
Indeed, the opposite view is that the Plaza Agreement succeeded only too
well—necessitating the 1987 Louvre Accord to slow the depreciation of the
dollar, and later prompting the October 1987 stock market crash (the response
to which is one of the few examples of monetary policy coordination among the
G7; Ghosh and Masson 1994).

Overall, the first 20 years of floating exchange rates were disappointing. Far
from adjusting smoothly to trade imbalances—as Friedman (1953) had argued—
both nominal and real exchange rates had been highly volatile (prompting
renewed impetus toward a monetary union in Europe, in the form of the
European Monetary System). Large imbalances had emerged among the major
industrialized economies, and developing countries had struggled with external
adjustment in the aftermath of the debt crisis. In addition, stagflation had beset
many economies in the wake of the oil price shocks, and experiments at policy
coordination had proven far from satisfactory. Trade growth remained robust
(despite the high degree of exchange rate volatility; Figure 1.12, panel 1), but
output growth was barely one-half of that attained during Bretton Woods, and
inflation was considerably higher (Figure 1.12, panel 2).

As the 1980s drew to a close, and developing countries (most notably in Latin
America) emerged from the “lost decade” of the debt crisis years, the role of the
IMF was again in question—but not for long. The collapse of the Soviet Union
and the fall of the Iron Curtain gave the IMF a fresh mandate: helping these
centrally planned economies first to stabilize following price liberalization and
then to transform into more market-oriented structures. Not surprisingly, there
was an increase in the IMF’s technical assistance and financing. An even greater
call on IMF resources came from the “capital account crises” in emerging mar-
kets—as these countries pursued rapid capital account liberalization in the 1980s
and early 1990s—starting with Mexico in 1994, and soon followed by the east
Asian economies in 1996/97, Russia in 1998, Brazil in 1999, Turkey in 2001,
Argentina in 2002, and Uruguay in 2003. Although the specifics differed across
these cases, what they all amply demonstrated was that the rise of private
cross-border capital flows, far from obviating the need for global liquidity (in the
form of foreign exchange reserves or IMF financing), had increased that need by
orders of magnitude (Figure 1.13).
The IMF in the Doldrums

By the early 2000s, as emerging markets recovered from these financial crises, capital flows resumed (Figure 1.14), and the need for IMF financing fell correspondingly. Meanwhile, among the world’s most important economies (which by now included China), large current account imbalances began to emerge in the
mid-2000s (Figure 1.15). On the deficit side, the United States was the major deficit country, while the largest surplus countries were China and other Asian emerging market economies, oil producers, and Germany. It was recognized that the current account surpluses of oil producers represented the transfer of their wealth from below the ground to above it, whereas Germany’s surplus largely escaped unnoticed because the euro area as a whole was roughly in balance. It was therefore the Asian surplus economies that came under particular scrutiny, with the charge that they were deliberately undervaluing their currencies to gain competitive advantage as part of export-led growth strategies. These countries countered that the Asian (and other emerging market) financial crises had taught them the importance of ensuring that currencies not become overvalued, and of holding sufficient international reserves to buffer against capital account shocks (especially given the political stigma of having to seek the IMF’s financial support).

Beyond the issue of possible unfair trade practices, the concern with the global imbalances was that, eventually, there could be a loss of confidence in the US dollar, which would force the Federal Reserve to raise interest rates sharply, with global repercussions. Such concerns about an abrupt unwinding of the global imbalances prompted the IMF to convene a “multilateral consultation” in 2006. This was a form of international policy coordination—albeit informal and outside the usual G5 or G7 setting—whereby surplus and deficit countries would undertake policies that, the IMF argued, would both be in their own interests and contribute to systemic stability.

Figure 1.14. Net Financial Flows to Emerging Market Economies, 1980–2013 (Billions of US dollars, left scale; percent of GDP, right scale)

Note: Net financial flows excludes reserves and other investment liabilities of the general government. Flows for 2013 are provisional. Net financial flows in percentage of GDP is the average computed over all countries in the sample.
The multilateral consultation, however, had very little impact. As before, nothing forced the surplus countries to adjust, while the main deficit country, the United States, continued to receive plentiful financing—and indeed was confident that, even if there were to be a crisis, the resulting “flight to safety” would be toward the dollar rather than away from it. Neither side, therefore, had much urgency to act. The IMF itself was very much in the doldrums: except for concessional loans to low-income countries, it was doing virtually no lending, and its surveillance activities had little traction in altering policies—especially those of its largest and most important members.

Things took a sharp turn as the global financial crisis erupted in September 2008; the IMF was back in business and very much on the front lines (shown in Figure 1.13, panel 2).

**CHALLENGES OF TODAY**

The main worry about global imbalances in the mid-2000s was the possibility that a sudden unwinding would lead to a sharp depreciation of the dollar. That did not happen: on the contrary, the immediate response was safe haven flows to the United States (notably Treasuries), strengthening the dollar against most currencies. But the global financial crisis did happen, and while the proximate trigger was the implosion of the US subprime mortgage market, the underlying cause has variously been attributed to the global savings glut (Bernanke 2005)—which resulted in excessive risk taking as investors searched for yield—or a global

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**Figure 1.15. Global Current Account Imbalances, 1980–2013**

(Percent of world GDP)

The chart illustrates the global current account imbalances from 1980 to 2013, highlighting the United States, China, Germany, Japan, EURSUR (euro area surplus countries), EURDEF (euro area deficit countries), OIL (oil exporters), and ROW (rest of the world). The source is the IMF World Economic Outlook database.

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“banking glut” (Shin 2012), with overleveraged financial institutions that have cross-border assets (both explanations are reminiscent of the interwar period, prior to the 1931 sudden stop).

Yet, outcomes in the Great Recession have been significantly better than during the Great Depression (Figure 1.16)—partly because of vigorous monetary and fiscal measures (including coordinated G20 fiscal stimulus in the immediate aftermath of the crisis), and partly because countries did not succumb (nearly as much) to trade protectionism. The contraction in world trade has therefore been much shorter-lived than during the interwar period (Figure 1.17).

Nevertheless, there are some eerie similarities between the Great Depression and the Great Recession: highly volatile capital flows, a scramble for reserves, asymmetry in the burden of adjustment between deficit and surplus countries, secular stagnation, and currency wars.

**Volatile Capital Flows**

As in the interwar period, capital flows to the emerging markets have been highly volatile (shown in Figure 1.14). The immediate impact of the global financial crisis was large outflows from emerging markets to safe havens, notably the United States. With record monetary expansion, low returns, and diminished growth prospects in advanced economies, however, capital surged toward emerging markets in mid-2009 and early 2010. But the US sovereign debt rating downgrade at the end of 2011 sent capital scuttling back to the United States—ironically, into Treasuries. Thereafter, flows returned to emerging markets—until the “taper tantrum” in the second half of 2013, when the Federal Reserve announced its intention to wrap up the unconventional monetary policy measures (quantitative easing) that it had introduced in the aftermath of the crisis to boost economic recovery.

This volatility raises questions of how emerging market countries should respond. Should they simply allow capital to flow in and out of the country without regard to the macroeconomic and financial vulnerabilities that large flows may engender? Should they intervene in the foreign exchange market, incurring sterilization costs? Should they impose capital controls and risk financial deglobalization? Finally, what should be the responsibility of source countries when cross-border capital movements (especially banking flows) are destabilizing?

**Scramble for Reserves**

One way that emerging markets have been protecting themselves is by stockpiling reserves, with the average reserves-to-GDP ratio rising from about 12 percent of GDP before the Asian crisis to over 22 percent of GDP in 2013 (Figure 1.18). The global financial crisis made only a slight dent in the series, with the trend of accumulation accelerating after the crisis. But such reserve accumulation may also have downsides. First, it is an inefficient form of country insurance. Second, unless financed by long-term, stable capital flows, the buildup of net reserves requires emerging markets to run current account
Figure 1.16. Macroeconomic Performance: Great Depression vs. Great Recession

1. Decline in Real GDP per Capita (Percent)

2. US Peak Unemployment Rate (Percent)

3. US Inflation Rate (Percent)

Sources: Based on New Maddison Project (Bolt and van Zanden 2014); Federal Reserve Bank of Minneapolis; US Bureau of Labor Statistics; and US Census Bureau.

Note: Decline in real GDP per capita is computed over peak to trough (panel 1); unemployment rate is for individuals 14 years of age or older in 1933 and for individuals 16 years of age or older in 2010 (panel 2); inflation rate is mean for period average (panel 3).
Figure 1.17. World Trade Collapse: Great Depression vs. Great Recession

1. Great Depression

2. Great Recession

Sources: Kindleberger 1973 (panel 1); and World Trade Organization data (panel 2).

Note: Panel 1 is based on total imports of 75 countries (monthly values in terms of old US gold dollars in millions). Panel 2 is based on monthly merchandise imports of 70 countries.
surpluses. Third, reserve accumulation raises the global demand for safe assets, depressing their rate of return—thus worsening the zero-lower-bound problem for advanced economy monetary policy.

**Asymmetric Burden of Adjustment**

The euro area crisis has again highlighted the difficulties that deficit countries face in undertaking external adjustment, especially when the nominal exchange rate is not available as an adjustment tool. Although intra–euro area imbalances were not the focus during the multilateral consultations on global imbalances in the mid-2000s, current account adjustments of the hardest hit euro area countries (and, earlier, in some eastern and central European countries) has been associated with severe output declines (Figure 1.19). At the same time, Germany—the largest surplus country within the euro area—has done little rebalancing toward domestic demand; indeed, its overall fiscal position has turned to surplus.

**Secular Stagnation**

Beyond the immediate crisis, the largely anemic recovery even in advanced economies where growth has resumed has led to worries of “secular stagnation” (Summers 2013). The term was originally coined during the Depression era by

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**Figure 1.18. Stock of Foreign Exchange Reserves in Emerging Markets, 1980–2013**

(Billions of US dollars)

Figure 1.19. Current Account and Real GDP Growth, 2008–13
(Percent)

Source: IMF, World Economic Outlook database.
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Alvin Hansen (1939), who noted that “a full recovery calls for something more than mere expenditure of depreciation allowances. It requires a large outlay on new investment, and this awaits the development of great new industries and new techniques. But such new developments are not currently available in adequate volume.”

The concern is that, with monetary policy close to the zero lower bound, and with inadequate aggregate demand, businesses have little incentive to undertake new investment—in turn, condemning the economy to slower potential growth as well. Whether, in fact, the world economy has entered a period of secular stagnation is the subject of considerable debate. Certainly, investment rates have fallen significantly in major economies since the onset of the global financial crisis (Figure 1.20). Recent data on US growth have been more encouraging—but conversely, emerging markets, which had been the one bright spot of the world economy after the global financial crisis, have now slowed considerably, and their growth prospects seem much diminished compared with even a couple of years ago (Figure 1.21).

Currency Wars

From the perspective of the international monetary system, secular stagnation raises concerns about “currency wars.” With monetary policy at or close to the zero lower bound, and with limited fiscal space, the main scope for boosting aggregate demand is through exports, via currency depreciation. If this happens, the global economy could be thrown back to the interwar world of competitive devaluations.

Empirically, various unconventional monetary policy expansions in Japan, the United States, and the euro area have indeed been associated with depreciation of the corresponding currency, and some advanced economy central banks—Switzerland and the Czech Republic—have been intervening in the foreign exchange markets on grounds that their policy rates are at the zero lower bound, but they have insufficient domestic assets to undertake quantitative easing (Figure 1.22). It is noteworthy, however, that these central banks generally do not consider that they are deliberately depreciating their exchange rates—rather, the defense is that they are seeking to fulfill their (typically, 2 percent a year) inflation targets. But with “divine coincidence,” meeting the inflation target is equivalent to closing the output gap, which requires boosting aggregate demand—including by raising net exports. Meanwhile, for trading partners, it makes little difference whether the country’s exchange rate depreciation (and hence trading partners’ loss of competitiveness) is the result of monetary policy (quantitative easing) or exchange rate policy (foreign exchange intervention).19 In this sense, a world of secular stagnation is also likely to be a world of currency wars.

19As in the interwar period, competitive devaluations provide some benefit to the world economy inasmuch as they allow expansionary monetary policies. Likewise, although quantitative easing might be negatively transmitted through the exchange rate, there could be a positive benefit through reflation.
Figure 1.20. Investment, Inflation, and Growth, 2005–13
(Percent)

- Gross fixed capital formation, public (to GDP)
- Gross fixed capital formation, private (to GDP)
- Real GDP growth rate
- CPI inflation rate
- Interest rate

1. United States

2. Euro area

3. Japan

Sources: EUROSTAT; and IMF, International Financial Statistics and World Economic Outlook databases.
Figure 1.21. Projected Real GDP Growth Rates, 2008–17
(Percent)

1. Advanced Economies

2. Emerging Market Economies

Source: IMF, World Economic Outlook database.

Figure 1.22. Quantitative Easing and Real Effective Exchange Rate, 2008–13

1. United States (Index)

2. Japan (Index)

Source: IMF, Information Notice System database.
Note: QE dates are from IMF 2013. CME = comprehensive monetary easing; QE = quantitative easing; QQME = quantitative and qualitative monetary easing program.
VOLUME OVERVIEW

With this broad narrative as a backdrop, the chapters in this book delve deeper into particular aspects of the international monetary system over the past century. The chapters are wide ranging, but they may be grouped under four broad rubrics:

Part I, “Perspectives from the Past: Imbalances and the Asymmetric Burden of Adjustment,” looks at historical antecedents of today’s challenges. In Chapter 2, Harold James reexamines the interwar period from the perspective of current and capital account imbalances (or, put differently, in terms of net and gross flows). In Chapter 3, Emmanuel Mourlon-Druol looks at European adjustment experiences in the 1960s and 1970s to draw lessons for today. Catherine Schenk takes a more global perspective in Chapter 4 and recounts how policy coordination failures since Bretton Woods have contributed to large and persistent imbalances; and in Chapter 5, Michael Bordo and Harold James explain the problem of adjustment in terms of four distinct policy constraints or “trilemmas” that arise from international capital mobility.

Part II, “International Monetary Negotiations and the International Monetary System,” goes “behind the scenes” of how the modern international monetary system has been—and continues to be—shaped through international financial diplomacy. In Chapter 6, Eric Helleiner debunks the myth that Bretton Woods was the brainchild of Keynes and White alone; although these men were undoubtedly the main protagonists, he argues that there were substantial and important contributions from the delegates of many of the 44 nations represented at the conference, including developing countries and colonies. Benn Steil brings the same theme forward in time in Chapter 7, asking whether, or to what extent, emerging markets today are trying to craft new institutions that will result in a less G7-centric international monetary system. James Boughton reminds us in Chapter 8 of the central role the IMF has played—and continues to play—in the modern-day international monetary system.

Part III, “Currency Wars and Secular Stagnation—The New Normal?” brings the discussion to the present day. Richard Cooper proposes an indicator-based approach in Chapter 9 to discipline exchange rate policies, particularly of surplus countries that are typically not subject to market discipline. In Chapter 10, Robert McCauley looks at monetary spillovers and the possibility of national policies being at cross purposes in globally integrated bond markets where assets are close substitutes. Edwin Truman in Chapter 11 assesses the issue of global liquidity and asks whether the IMF has sufficient resources to assist countries facing balance of payments difficulties (he also proposes ways that the rest of the IMF membership could move forward on quota reform without the participation of the United States—and such thinking likely helped spur the US Congress to approve the quota increase in December 2015).

Part IV presents a brief overview of the analytics of international policy coordination by Atish Ghosh, and the proceedings of a panel discussion (moderated by Olivier Blanchard) on “Prospects for the Future: Toward a More Cooperative...
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System,” with Maurice Obstfeld, José Antonio Ocampo, Alexander Swoboda, and Paul Volcker as panelists. The key takeaways from the discussion—summarized by Atish Ghosh and Mahvash Qureshi—wrap up this volume.

REFERENCES


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From Great Depression to Great Recession
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