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Comment on "International Monetary Regimes" (by Charles Goodhart and Dimitrios Tsomocos)

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It is a pleasure to discuss Charles Goodhart and Dimitrios Tsomocos's interesting and eloquent paper at this conference in honor of the memory of Curzio Giannini, although I have to say I feel that ultimately the logic of his argument leads in a direction that may be dangerous.

Goodhart starts appropriately with a discussion of the current situation in terms of a typology laid out by Giannini of international monetary regimes as hegemonic (e.g. the dollar standard), cooperative (Bretton Woods/EMS), or consortium (EMU), and concludes that the situation is "worsening," and certainly getting more confused.

It is indeed difficult to categorize the current monetary regime neatly into any of these categories, but in a way it always was. The realities are mixtures of all three elements, and the modern classificatory endeavor is reminiscent of Shakespeare's Polonius who categorizes plays as "tragedy, comedy, history, pastoral, pastoral-comical, historical-pastoral, tragical-historical, tragical-comical-historical-pastoral, scene individable, or poem unlimited." Our international monetary system indeed has tragical and historical elements, and there is at least irony if not comedy in the way that the outcomes do not really correspond with the intentions of the individuals and institutions who set up the system.

The Bretton Woods regime, as well as the EMS, were quite distinctly hegemonic as well as cooperative: though there were 45 countries represented at Bretton Woods, the main negotiations were all between the UK and the US, and it was the stand of the US that really mattered. In the same way, the EMS was formally a cooperative arrangement, but its reality worked around a German-French relationship, and most observers believed that the result was in fact a German system that reflected German policy preferences. After they are created, these regimes are subject to contrasting and contesting interpretations as the idea of hegemony seemed to be inverted: thus Americans often felt constrained by the Bretton Woods regime (they alone could not change their parity) and Germans felt constrained by the EMS.

A consortium currency, such as the Euro, also includes elements from the past ("historical"), which include the "tragical" or hegemonic relations. Was the ECB conceived as a simple continuation and transposition to the European and cooperative level of the policy stance and preferences of the Bundesbank? Is it subject to a clash of monetary philosophies that sets up a clash of two systems of rights (Aristotle's view of tragedy)?

In this categorization, Goodhart assumes that money is issued by states. He follows a venerable tradition – one that was reasserted powerfully in the nineteenth century and reached its apogee in Georg Friedrich Knapp's *State Theory of Money*. Money could be issued by the state because of government's ability to define the unit of account in which taxes should be paid. In the *Nicomachean Ethics,* Aristotle explained that money owes its name to its property of not existing by nature but as a product of convention or law. Greek coins

usually carried depictions of gods and goddesses, but the Romans changed the practice and put their (presumed divine) emperors on their coins. Christ famously answers a question about obedience to civil authorities by examining a Roman coin and telling the Pharisees, "Render unto Caesar the things which are Caesar's." The design of the modern European consortium currency was a self-conscious break with that tradition. The design of the Euro makes the novelty clear. Unlike most banknotes and coins, there is no picture of the state or its symbols—no Caesar—on the money issued and managed by the European Central Bank. This feature sharply distinguished the new money from the banknotes that had circulated before the common currency and that were carefully designed to depict national symbols. Especially in the nineteenth century, the formation of new nation-states was associated with the establishment of national moneys, which gave the new polities a policy area in which they could exercise themselves. European leaders in the late twentieth century were self-consciously stepping away from that tradition – in large part because of a widespread sense that national money had been subject to political abuse, with inflationary consequences.

If money is necessarily created by the state, the next logical step is to think that its management must correspond with the interests of the state that is responsible. Within the hegemonic patterns, Goodhart distinguishes two problems that may impose impossible adjustment costs or confidence problems on the international system. A system based on a hegemonic creditor (as many feared the US would be after 1945, or as Germany was in the EMS) imposes a deflationary bias if it does not take actions that would erode its creditor status. On the other hand, a debtor-hegemon (like the US in the late 1960s) poses confidence problems. As Charles Kindleberger, Emile Depres, and Walter Salant showed in the 1960s, it holds out the possibility of a bank-run type event, in which foreign holders of the hegemon's debt lose confidence. Since the 1970s, this possibility still exists in the case of an international system in which the dollar plays a preeminent role, but the persistently-voiced fears of a large panic move out of the US dollar have so far not been realized.

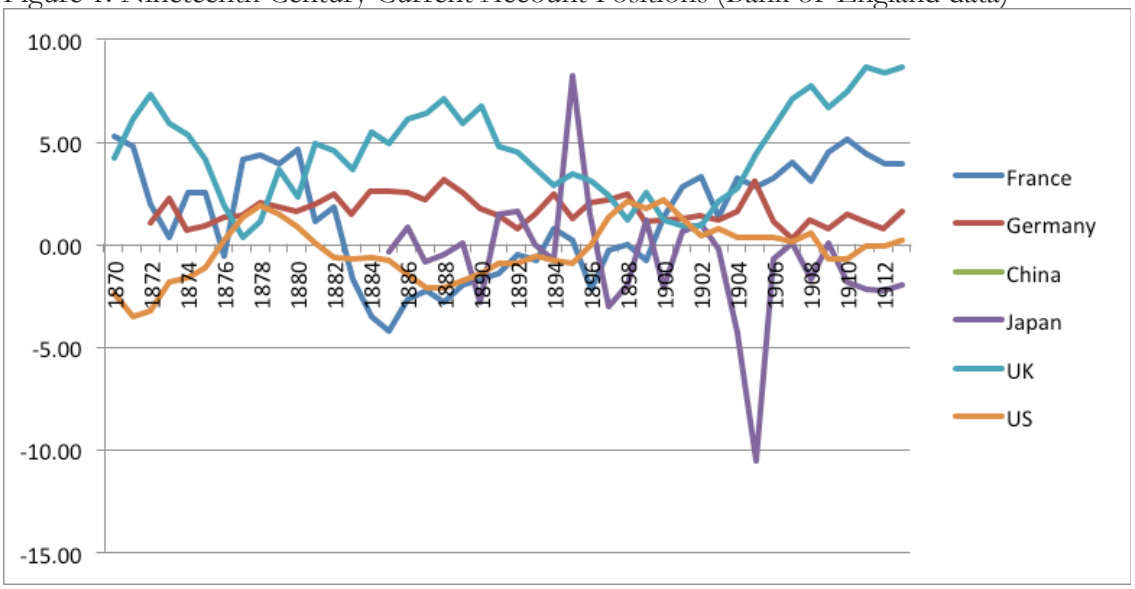
In Goodhart's view current account imbalances reveal the net asset position and thus the extent to which the control of the system by dominant countries threatens the international order. He rightly points out that international institutions have been completely incapable of addressing this issue: the IMF in confronting the "global imbalances" debate of the 2000s, and the ECB in dealing with growing imbalances in the Eurozone at the same time. So something else might be needed. But what?

Goodhart finishes with a proposal to use macroprudential bank regulation and supervision as a way of limiting cross-border financial flows, in effect, as he puts it, using the new macroprudential framework as a way of reintroducing capital controls. He is thinking of a way to operationalize the critique of the German surplus that is regularly articulated by the US Treasury.

There are analogies in his approach with that of the Bank of England in the 1970s, when the so-called "corset" was applied to bank lending in order to avoid macro-economic imbalances and their external consequences. I suspect that corsets are rather old-fashioned garments and that most people today would feel uncomfortable wearing them. I am not sure that they are needed on the international level.

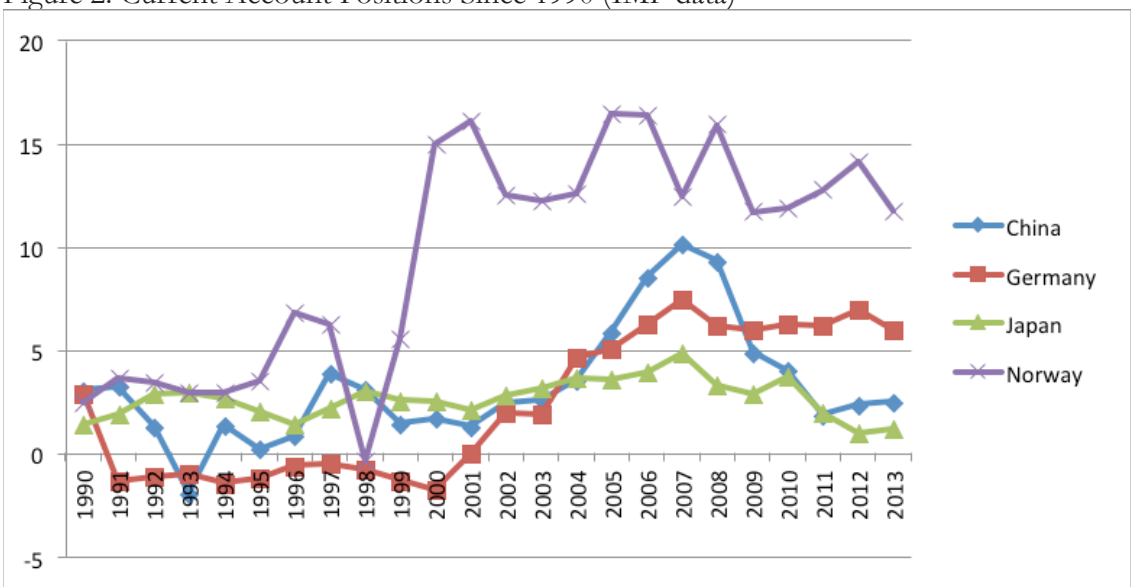
In the first place, there are many historical instances of substantial current account imbalances that are sustained over long periods of time without producing crises of confidence or adjustment problems. In terms of deficits, think of Australia in the nineteenth century (or indeed today); or in terms of surpluses, think of the nineteenth century UK. (Figure 1)

Figure 1. Nineteenth Century Current Account Positions (Bank of England data)



In today's world, the Chinese surpluses that gave rise to the extensive discussion of "global imbalances" in the 2000s are falling, the Japanese surpluses have been completely eroded, and the really large surplus current account positions are found in countries such as Norway, which no one supposes to be a threat to the international system. (Figure 2)

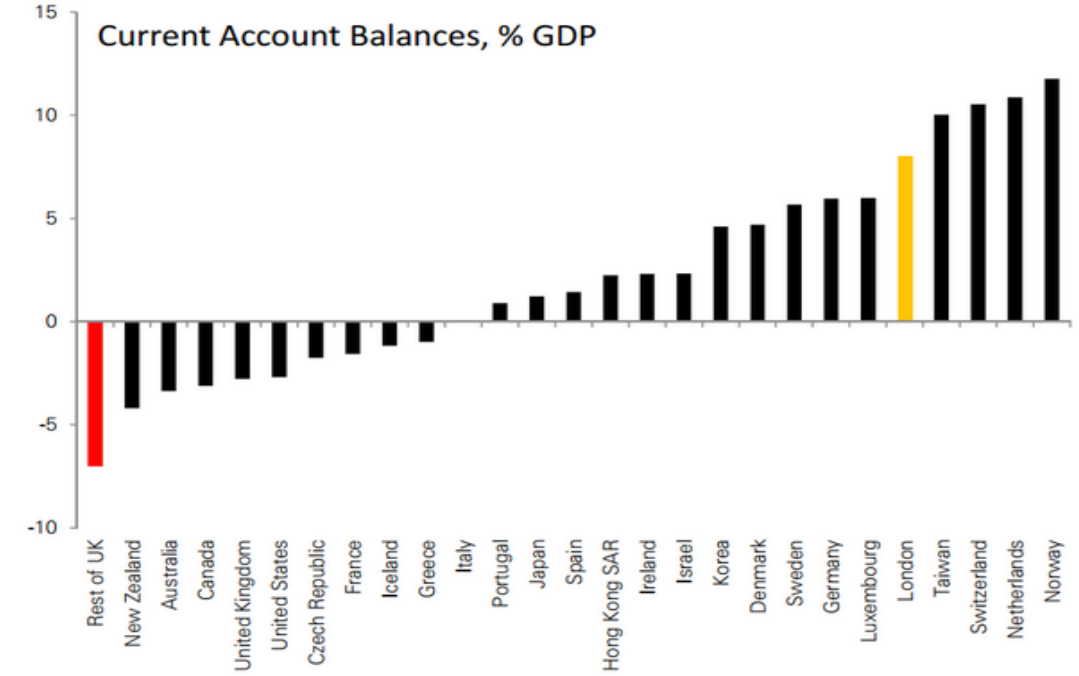
Figure 2. Current Account Positions Since 1990 (IMF data)



The problem of current account imbalances within a currency union is a logically different one, and does not in most circumstances provoke concerns. An interesting Deutsche Bank research paper recently estimated the current account surplus of London vis-à-vis the rest of the UK as 8 percent of GDP.[1]

[1] http://www.efxnews.com/story/21864/uk-currency-area-penny-pound-deutsche-bank

Figure 3. OECD Account Surpluses and Deficits (Deutsche Bank, ONS, OECD data)



In the contemporary Eurozone discussion, the focus should be on why lending channeled from North to South through the banking system provoked such instability. In theory, the flows from a richer North to a poorer, but more rapidly growing, South should have been mutually beneficial. It would help greatly in solving the Eurozone crisis if the private flows of capital resumed, and if official flows of central bank credit were not required as a substitute for the failure of the banking system. We should not really be looking for ways of limiting the flows as such, but we should be concerned about banks with unstable and dangerous balance sheets. Banking issues should not be addressed as a way to substitute for capital controls and to impose a renationalization of finance. The European problem is really a banking one; one solution to the problems of restoring the desirable flow of capital is already emerging, namely the greater use of capital markets by innovative and creditworthy private borrowers in southern countries.