IS THERE A FUTURE FOR INTERNATIONAL MONETARY COOPERATION?

James M. Boughton

> *International economic cooperation has delivered benefits to the United States and other countries that would have been impossible to attain otherwise. A major reason that the global financial crisis that began in late 2007 never turned into a second Great Depression is that the United States and other countries coordinated their efforts through the IMF and the G-20.*
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> — US Treasury Secretary Jack Lew (2016)

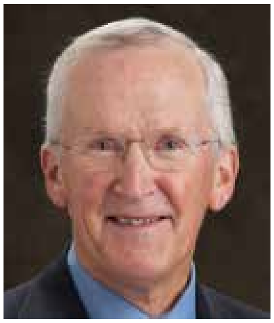
Economic conflict between nation-states has been a major concern throughout the past century and will continue to threaten progress for the foreseeable future. The language evolves, but the issues persist. The "beggar-thy-neighbour" policies and "competitive devaluations" that aggravated the Great Depression of the 1930s have become the "currency wars" of the twenty-first century. Defining the problem, however, is easy compared with the task of solving it. A central recurring question is whether policy makers can — and should — cooperate and try to coordinate their policies in an effort to alleviate conflicts and improve outcomes.

An important new book, *International Monetary Cooperation: The Plaza Accord after Thirty Years*, co-edited by C. Fred Bergsten of the Peterson Institute for International Economics and Russell A. Green of the Baker Institute for Public Policy at Rice University, examines one of the more successful past efforts to promote policy cooperation, in order to assess the prospects for future efforts. The book was launched in April 2016 at a conference at the Peterson Institute, at which Lawrence Summers was the keynote speaker. The focus of the book is a famous meeting of the finance ministers of five major countries — France, Germany, Japan, the United Kingdom and the United States — at the Plaza Hotel in New York City on September 22, 1985.

The exchange value of the US dollar had risen precipitously throughout the early 1980s, and in the second half of 1984 the global demand for dollars had apparently outstripped all reasonable expectations. None of the economic models in general use could explain it. Even the free-market true believers who populated the US Treasury in the first years of Ronald Reagan's presidency finally had to admit that a speculative bubble was driving the dollar's value to dangerous levels. The current account deficit was rising, manufacturing jobs were under threat and Congress was contemplating measures to protect US industry from foreign competition.

In January 1985, the United States responded to these pressures by intervening in foreign exchange markets in concert with other major countries, vacating the policy of intervening only in response to a very narrowly defined state of "disorderly market conditions." The dollar reversed course, but progress toward a sustainable level seemed to be agonizingly slow. Discussions among finance ministries intensified and led eventually to the Plaza meeting, at which the participants agreed to undertake a vigorous and publicly announced effort to realign exchange rates.

The Plaza Accord, as it came to be known, is widely acknowledged to have succeeded on two levels, although not permanently and not without qualification. First, it did seem to contribute to a continuing appreciation of other currencies against the dollar, which was its stated purpose. The question remains, however, whether the shifts might have occurred even without a formal agreement. Second, the meeting ushered in a period of sustained cooperation over the next two years and beyond, through a



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follow-up meeting at the Palais du Louvre in Paris in February 1987 (when participants agreed, at least vaguely, to try to stabilize exchange rates near their then-current levels). By the end of the 1980s, however, the process was abandoned.

What can one learn from this episode that would help prevent similar tensions from disturbing global trade and finance in the coming years? *International Monetary Cooperation: The Plaza Accord after Thirty Years* comprises the proceedings of a conference held at the Baker Institute for Public Policy at Rice University in October 2015 to commemorate the thirtieth anniversary of the Plaza Accord. The keynote speaker was the eponymous James A. Baker, III, who was also the political mastermind behind the Plaza meeting when he was secretary of the US Treasury. Following an overview by the book's co-editors, the first five chapters are recollections by participants at the Plaza: Baker, Federal Reserve Chairman Paul A. Volcker, Treasury officials David C. Mulford and Charles H Dallara, and Makoto Utsumi, vice minister of finance in Japan.

The next five chapters, by leading international economists, analyze and assess the Plaza Accord to determine what it did or did not accomplish. Each chapter expresses some skepticism about the meeting's effects on exchange rates independent of other changes in policies and economic conditions around the same time. More concretely, this part of the book provides helpful insights into *why* the meeting might have had at least some success. The direct mechanical effects of sterilized intervention on exchange rates might be small, but those effects can be magnified if the intervention is known by market participants to be part of a broader and coordinated strategy to realign rates. Thus, the context of the Plaza meeting is at least as important as the specific actions that it engendered.

The final part of the volume gets to the crux of the matter. What does the accord tell us about the prospects for a successful renewal of international policy cooperation? Chapters by Joseph E. Gagnon and John B. Taylor draw the lesson that a rules-based system is needed to overcome the vagaries of uncoordinated policies. Barry Eichengreen finds limited parallels with other historic events and concludes that effective leadership from heads of state and a modest set of shared objectives are among the key contributors to success. C. Fred Bergsten (2016, 294) cautions that current US policy, under adverse pressure from Congress, does not seem conducive to productive international cooperation: "It is thus not yet time for a Plaza II."

Future prospects for cooperation hinge on the similarities and differences between circumstances then and now.

The first similarity is that exchange rates today are — by some estimates — again seriously misaligned relative to the rates that would be consistent with sustainable external payments positions. Bergsten's concluding chapter in the volume provides a detailed analysis and concludes that the Japanese yen may be undervalued by as much as 23 percent; the renminbi and the euro by 10 and six percent, respectively; and the US dollar overvalued by as much as 16 percent. Thus "the current situation is very similar to the one that prevailed before the Plaza" (ibid., table 14.5; 280). Other analysts would derive smaller numbers, but the direction at least is clear. Whether all of the key-currency countries share the goal of realigning rates is less clear.

Second, the United States — for the time being — is still the *primus inter pares*. A key feature of the Plaza meeting was its focus on the dominant role of the dollar. Throughout the postwar period since 1945, the economic importance of the United States and the financial importance of the dollar have determined the course of the global economy far more than any other country or currency. The universal desire to realign the dollar with other major currencies and thus reduce the size of current account imbalances drove the decision to hold a joint meeting of senior finance officials in 1985. Thirty years later, despite the rise of China to near parity in economic size, the United States remains the dominant force in international finance. Without the full support and involvement of the US authorities, no effort to cooperate in setting exchange or macroeconomic policies would have any chance of succeeding.

A key difference, however, is that the grouping of five countries that met at the Plaza is no longer relevant. The core of any coordination effort today would be the United States, China and Germany (as the de facto leader of the euro area). France, Japan and the United Kingdom would expect to have seats at the table, but would have little role to play in determining the outcome. Similarly, Canada, Italy and Russia — which eventually became part of the Group of Eight (G8) leading economies by the late 1990s — would have little influence. Nor would the other members of the Group of Twenty (G20), although that broad group is now the principal setting both for finance meetings and for annual summits. A much larger number of countries — close to 20 rather than five — would have to participate, but the agenda would be controlled by a very few.

Even assuming that US leadership is available and active, and that all of the major countries agree that a cooperative process would be helpful, the challenges are daunting. One general problem is that cooperation requires trust between national leaders and finance officials. Trust is difficult to achieve except in particular circumstances when national interests happen to coincide. International negotiations involve a delicate dance in which everyone has to pretend to be working toward improving global welfare, even though everyone is understood to be working to promote national interests. Because the United States has such an outsized role in international finance, participants from other countries understand that US interest in the process is motivated primarily by a desire to co-opt them into furthering US objectives. At the time of the Plaza meeting, all five countries shared an interest in reversing the overvaluation of the dollar. The absence of real conflict enabled an unusual degree of trust and made policy coordination possible. Such circumstances, however, seldom occur.

It is not yet time for a Plaza-type agreement because the basis for success — a sharing of national interests among participants — does not currently exist. Suppose, however, that the strength of the dollar were to begin to bite more severely on US economic growth, while Chinese growth continued to decline and the EU economy remained in the doldrums. That combination could give rise to a commonality of purpose similar to the conditions that precipitated the "locomotive" strategy embraced by the Group of Seven (G7) summit in Bonn, Germany, in July 1978. Although that strategy floundered, a modern incarnation might have a greater chance of success because the structural underpinnings of economic sclerosis are now much more well understood. Alternatively, suppose that the current misalignment of exchange rates were to lead to a heightened instability of rates and a serious risk of a large disorderly move out of dollars. That circumstance would be similar to the situation in 1985, and could motivate a common search for a more stable order in international finance. In short, the major countries need to be on the brink of crisis before a Plaza II would be seen as a helpful part of the solution.

These considerations suggest that as long as policy cooperation is sought through the periodic meetings of ad hoc small country groupings, it will never succeed more than rarely, and it is unlikely to be timely enough to be effective. As the relevant group has expanded from the Group of Five to the G7/G8 and then to the G20, it has become more inclusive and legitimate, but it has also become less wieldy and less pertinent to the problem at hand. Inevitably, the G20 will give way to other combinations as leaders try repeatedly to find the right mix. Policy coordination will thus awaken from time to time, but will not become a regular feature of global economic management.

The proper locus of international economic cooperation is the permanent organization that was founded by treaty for that purpose, the International Monetary Fund (IMF). Unfortunately, the IMF has been hobbled from performing that task effectively. Its main governing body, the 24-member International Monetary and Financial Committee (IMFC), has the great advantage of representing all 189 member countries via a constituency system. It meets twice a year and provides guidance to the IMF on all aspects of policy. The long-standing problem is that the formality of the IMFC has almost always rendered it incapable of innovation or flexibility. Its pronouncements are practically foreordained.

The general shortcomings of the IMFC have been compounded in recent years by two additional problems. First, the governance of the IMF has been slow to catch up with the rapid economic growth of emerging market countries, in particular China and India. The recent long-overdue ratification of a major reform package has improved matters somewhat, but the governance lag continues to weaken the political legitimacy of the IMFC as a steering committee for international policy cooperation. Second, the rise of the G20 as the dominant outside group has rendered the IMFC virtually powerless to play an independent role in determining IMF policies or advising on the direction of financial policies. Whenever a meeting of the IMFC is scheduled, the G20 finance ministers meet a few days earlier and issue a communiqué covering the key issues that they regard as important for international finance. Because the G20 controls around three-quarters of the voting power in the IMF, the formal institution has no choice but to follow suit.

For these reasons, if international policy cooperation is ever to become a regular feature of global economic affairs, a revitalization of the IMF will have to precede it. As several studies — see Palais Royale Initiative (2011), James M. Boughton (2014) and Malcolm D. Knight (2014) — have argued recently, that effort must include a rebalancing of the relationship between the IMF and the G20. Views differ on the best way to do this, and no one thinks it will be easy. The alternative, however, is that cooperation will be elusive and episodic, and conflicts will remain difficult to resolve.

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