

Conference on the International Monetary System, on the 70th anniversary of Bretton Woods, Hangzhou China, May 17-18, 2014.

Remarks by Richard N. Cooper, Harvard University

I would like to thank the organizers for holding a conference on this important topic. I will start with some autobiographical remarks. I was personally involved in the original conception and design of what became the SDR, and I was directly or indirectly involved in the three issuances of the SDR that were decided, in 1969, 1978, and 2009. In the early 1960s I was on the staff of the Council of Economic Advisers in the Kennedy administration, and the chief aide on international monetary issues to James Tobin, who in turn was a member of the Long-Range International Payments Committee, encouraged by President Kennedy (over reservations by the US Treasury) through Carl Kaysen, his deputy assistant for national security affairs. We took seriously the original Triffin Dilemma, long before its recent transformations and distortions, and sought a solution. In the mid-1960s I was in the US State Department as monetary deputy to Anthony Solomon (later president of the Federal Reserve Bank of New York in the 1980s) when what became the SDR was designed, now with active support of the US Treasury (Henry Fowler was Secretary of Treasury) and of President Lyndon Johnson through Francis Bator, his deputy assistant for national security. I was working on the National Security Council staff for Henry Kissinger in 1969, a year of tight money and flows of capital into the United States, when the decision was made for the first issuance of SDRs, which had been notionally created in 1968. I was working for the State Department again in 1978 (and Solomon was Undersecretary of Treasury for International Affairs), when the second issuance of SDRs was agreed. I was not directly involved in the decision for the large third issuance of SDRs in 2009, but two of my former Yale students (and perhaps Robert Triffin's students as well), Edwin Truman and Janet Yellen, and especially one of my former Harvard students, Lael Brainard, were importantly involved.

I cite this background to indicate that I have been a supporter of what became the SDR from the beginning, and also of increasing its role in the international monetary system. I consider myself one of the many grandfathers of the SDR, and have nostalgic feelings towards it. If I had a magic wand, I would transform all of today's official foreign exchange and gold reserves, beyond working balances, into SDRs. As indicated below, I would also enlarge the capacity of the IMF to issue SDRs, and engage in regular and as needed irregular issuances of SDRs.

We do not have such a magic wand. But we can play a thought experiment. Imagine that the world's central banks held as their foreign assets no dollars or euros or other national currencies (beyond relatively small working balances), only SDRs, and that the national currencies now held in reserves were locked away in a substitution account at the International Monetary Fund. How much difference would that make to the performance of the international monetary system and of the world economy? My guess is that it would make very little difference, discernable in normal times only to specialists. I believe many people wrongly associate the influence of US policy and developments in the American economy on the rest of the world with the international role of the US dollar. In reality these influences are due to the size and the character of the American economy, and particularly the size and the character of US financial markets. *The Economist* recently reported a calculation by Jonathan

Anderson that investors around the world have access to \$56 trillion in American stocks and bonds [including over \$10 trillion in US Treasury securities], \$29 trillion in euro-denominated assets [including around \$2 trillion in German government bonds], \$17 trillion in Japanese securities, but only \$0.3 trillion in Chinese securities, and similarly small amounts from many other countries. In short, the American economy accounts for between a fifth and a quarter of world economic output, and roughly half of internationally available securities by value. Under these circumstances, in an interdependent world economy developments in the American economy and financial markets, including US economic policies, are bound to have a strong influence elsewhere, independent of any international monetary role for the US dollar. Indeed, one could argue that the international role of the dollar is itself due mainly to these magnitudes, although the two world wars and their consequences also played a role.

Another common misconception is that a country whose currency is used extensively around the world needs to run current accounts deficits to supply the growth in world demand for that currency. It is true that the United States has run such deficits for the last 30 years (excluding 1991). But it ran current account surpluses during the 1950s and 1960s when international monetary use of the dollar was growing rapidly, and Germany ran surpluses during the 1980s when international use of the German mark was growing. The increased supply of each currency during these periods was provided by private capital outflows that exceeded the current account surpluses, and that could occur as well in the future. Current account deficits are not necessary.

As I indicated above, I would prefer an SDR-based international monetary system. But we have no magic wand to bring it about. It would therefore have to be negotiated by governments, and the negotiations, we know from past efforts to negotiate changes in the international monetary system, would be difficult and likely contentious. Would the gains from shifting to an SDR-based system exceed the costs, given the many other issues on the international negotiating agenda – climate change, non-proliferation, international financial regulations, and the future of the trading system, to name only four -- and the limited capacity of leaders to handle many high-level issues at once? I do not know the answer, but even to ask the question suggests doubts.

My main point, however, is that we cannot have an international negotiation on the liquidity aspects of the international monetary system without also addressing the adjustment aspects, and especially the asymmetric pressures on countries in balance-of-payments deficit compared to those in surplus. This is an old issue, going back to Keynes' failed effort to address it successfully at Bretton Woods, 70 years ago. Focusing on current accounts, the problem was seen to be the United States in the 1950s (recall the "dollar shortage"), Germany in the 1960s, OPEC in the 1970s, Japan in the 1980s, China in the 2000s, and Germany again in the 2010s. But in a world with an increasingly globalized capital market, and big differences in growth prospects and in demographic profiles, should we focus only or even mainly on current accounts? Intertemporal trade can enhance welfare in both surplus and deficit countries.

I believe a more appropriate focus is on growth in official reserves, which reflects official intervention in foreign exchange markets. If reserves threaten to be depleted, adjustment is necessary. If reserve growth is excessive, international rules should require adjustment, introducing some

symmetry into the process. How should we define “excessive,” especially in a growing world economy in which some reserve growth over time is to be expected? That would require a difficult negotiation. I have suggested elsewhere (in *Central Banking*, May 2011) that each country should specify its desired growth in reserves over, say, the next ten years, that these expressed desires should be subject to international review and if necessary adjustment, and that the IMF should then create the resulting total in new SDRs over the agreed period, matching supply to expressed and agreed demand. Countries that deviated systematically over time from their agreed targets should be expected to adjust their international payments positions accordingly. Failure to do so would permit importing countries to impose discriminatory trade restrictions on products from the non-complying surplus countries, as permitted in principle under the World Trade Organization.

Thus on this proposal international adjustment and international liquidity are intimately related, as they are in general, so any negotiation on provisions of international liquidity must also take into account the adjustment mechanism. Do such negotiations have any prospect of success? The discussions at the G20 summit meeting in 2010 in Seoul do not suggest optimism. More discussion is required at conferences such as this, and in informal discussions with officials, to build a consensus among the major countries on what is desirable and achievable. It is not enough to grumble about existing international monetary arrangements. Concrete, operational proposals, such as the one I have suggested, should be put on the table for discussion.