



**BANK OF ENGLAND**

# News release

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## **Do we need an International Monetary System? - speech by Mervyn King**

The Governor of the Bank of England, Mervyn King, today calls for a "grand bargain" to bring about a global rebalancing and avert a move towards protectionism.

In a speech to the Stanford Institute for Economic Policy Research in California, the Governor notes the importance of international trade and hence an effective International Monetary System. But he goes on to highlight externalities in that system which caused high savings in some countries and high borrowing in others. This resulted in global imbalances characterised by large current account surpluses and deficits, and "unsustainable paths for domestic demand, net debt and long-term real interest rates". While the ensuing crisis elicited an unprecedented policy response, he says this "simply postponed much of the required adjustment in spending patterns around the world".

The Governor notes that countries can pursue policies that are inconsistent at a global level for long periods and that when adjustments come they can be abrupt. He asks, therefore, how we can reform the current system of monetary arrangements.

He says: "Central to any solution is a problem that has not been resolved since the Bretton Woods conference in 1944, namely the asymmetric pressures on, and responsibilities of, deficit and surplus countries to adjust their spending patterns".

The Governor highlights the fact that the adjustment path that would be chosen by high saving economies is different from that of highly indebted countries. "Their need to deleverage and reduce borrowing means that, if another abrupt adjustment is to be avoided, they cannot risk taking too long to rebalance their economies. In contrast, many of the emerging economies continue to require rapid economic growth and abundant employment opportunities in their export industries to ensure adequate levels of employment for their vast populations."

He says the political tension generated by these divergent preferences risks moves towards protectionism, as happened in the 1930s. "So there must be scope, in the short term, for a 'grand bargain' to adopt a set of policies that would support an agreed path of rebalancing and avert a move towards protectionism."

This should comprise five elements:

1. an agreed path for the reduction or increase of net exports relative to domestic demand;
2. an agreed framework for allowing real exchange rates to support the path for unwinding the imbalances;
3. a set of rules governing the circumstances in which countries would be able to limit short-term capital flows;
4. macro-prudential policies to limit the build-up of imbalances and add to the instruments available to pursue financial stability; and
5. structural policies, including fiscal measures, to raise national savings in deficit countries and to lower savings in surplus countries.

The Governor goes on to say that once rebalancing has been achieved, there is a longer term question of how to prevent a recurrence. He suggests reforming the governance of the IMF, which, in time, "might even be the vehicle for a more rules-based framework for the IMFS (International Monetary and Financial System), based on a judgement about the sustainability of the pattern of world demand".

The Governor says: "Although that seems a distant prospect today, there is a precedent . the WTO already plays a similar role in international trade."

The Governor concludes that there is much to do. "None of the underlying causes of the crisis have been removed", he says, adding that " . the imbalances are growing again. And continuing high debt levels, although in many ways a natural response to low long-term interest rates, leave indebted countries particularly vulnerable to a rapid reversal of high saving rates in surplus countries and a rise in long-term interest rates - surely inevitable in the long run - which would drive down asset prices."

"It is clear that these vulnerabilities affect us all. So recognising our common interest in moving to a more sustainable pattern of world demand is in our self-interest."

## **Key Resources**

**Do we need an International Monetary System? – Full speech**