50 Years after Bretton Woods: What Is the Future for the International Monetary System? An Overview

Rachel E. Cononi and Rebecca Hellerstein

Research Assistants, Federal Reserve Bank of Boston. *This article summarizes a session of the annual meeting of the Eastern Economic Association, March 18, 1994.* *The authors thank Jane Sneddon Little for helpful comments.*

This Eastern Economic Association roundtable discussion, held on March 18, 1994 at the Federal Reserve Bank of Boston, examined the future of the international monetary system in light of the aims of the Bretton Woods agreement of 1944. The title of the roundtable captures the central concern of each speaker: To what extent can the ideals of the founders of the Bretton Woods system be implemented today, given the changes in underlying economic conditions since that time?

Each speaker offered a distinct response to that question, drawn from the unique perspective of his background. J. Dewey Daane, a professor at Vanderbilt University, offered a historical perspective as he introduced the panel. Charles Taylor, Executive Director of the Group of Thirty and Project Director of the Bretton Woods Commission, gave some of his personal views on directions the International Monetary Fund and the monetary system might take. Richard Erb, Deputy Managing Director of the International Monetary Fund, explained the current process of international monetary collaboration among its members known as IMF surveillance. Scott E. Pardee, Chairman of the securities firm Yamaichi International (America) Inc., argued that the international monetary system functions effectively only when market participants can ally themselves confidently with the stated monetary policies of national governments. And Stefan Schoenberg, Executive Director for Germany at the IMF, emphasized that currency competition in today's world is basically policy competition. Moderator for the panel was Richard F. Syron, President of the Federal Reserve Bank of Boston.

Introductory Remarks: A Historical Perspective

J. Dewey Daane introduced the roundtable, noting that while the focus of the discussion to follow clearly would be on "where we go from

The Bretton Woods Payments System: A Brief History

The establishment of a new and more stable system of multilateral trade and payments was one of the most important tasks facing world leaders at the close of the second World War. Delegates from 44 nations gathered at Bretton Woods, New Hampshire in July 1944 with a common vision—to devise a monetary system that would encourage international cooperation. They were driven to reform the international monetary system by fears of a return to the dramatic slumps and booms that scarred the interwar years. During the Great Depression, the system of gold convertibility that had been in place since 1880 came to a grinding halt. The years that followed were characterized by fluctuating exchange rates, competitive devaluations, and increasing use of restrictive trade practices.

The Bretton Woods delegates designed a framework for a new payments system intended to promote economic recovery and the expansion of trade. The conferees laid the foundation for their new monetary regime in the Articles of Agreement of the International Monetary Fund, which provided for a system based on pegged but adjustable exchange rates and an institution, the International Monetary Fund (IMF), that would administer the system, operate as a central bank for central banks, and assist countries experiencing periodic balance of payments difficulties. The Fund Agreement provided for a system of international credits, available to member countries to finance temporary balance of payments difficulties; currency convertibility, at least for current account transactions; and the prohibition of discriminatory currency practices.

The new monetary regime did not become fully operational until 1958 when, after an extended period of postwar reconstruction, European currencies became fully convertible. The strengthening of European currencies in the late 1950s mirrored the increasing weakness of the U.S. dollar, however. The dollar's weakening, accompanied by repeated challenges to the international monetary system, gradually led to an erosion of confidence in the system.

By the early 1960s, the U.S. dollar had become overvalued relative to gold and other currencies. Government persistence in maintaining fixed exchange rates in the face of fundamental payments imbalances led to heavy speculation. Disequilibria built up, resulting in a series of currency crises that progressively undermined the fixed-rate system. Indeed, one fundamental weakness in the key currency system established at Bretton Woods was that it required the United States to run balance of payments deficits in order to supply other countries with needed liquidity through increased foreign exchange reserves. Supplying this liquidity while maintaining a fixed exchange rate resulted in U.S. gold reserves becoming increasingly inadequate to guarantee dollar convertibility at $35 per ounce, further eroding international confidence in the Bretton Woods system.

A variety of solutions were proposed regarding the reform of the international liquidity mechanism, but decisive action was not taken until March 1968, when the IMF created Special Drawing Rights (SDRs), a new reserve asset to substitute for dollars. By 1969, however, the international economy was experiencing severe strains and the convertibility of the dollar was increasingly in doubt. In addition, lowered barriers to capital flows accelerated the speed with which dollars could be transferred from the United States to Europe. With enormous pools of capital becoming increasingly mobile, the maintenance of fixed exchange rates became ever more difficult. In August 1971, U.S. President Richard M. Nixon shocked the world with his announcement to set the dollar loose from gold.

Nixon's startling announcement prompted the Smithsonian Agreement of December 1971, a last-ditch attempt by the ministers and governors of the Group of Ten to save the Bretton Woods system. The agreement prescribed devaluation of the dollar against gold, a multilateral realignment of exchange rates, and expansion of the narrow bands of fluctuation around the newly fixed values. In addition, the EC Snake, a technical mechanism for aligning currency movements within the European Economic Community, was created. Despite these measures, the revised system fell apart after little more than a year.

In April 1973, the exchange rates of all major industrial countries began to float against the dollar. During this time the IMF's Committee of Twenty attempted to reconstruct international monetary institutions on the basis of pegged exchange rates. Their efforts collapsed, however, in 1974.

The regime that eventually emerged was based on managed, flexible exchange rates. In January 1976, the Second Amendment to the Fund Agreement ratified the international laissez-faire system that had taken hold after the demise of the Bretton Woods payments system. According to the amendment, the stability of exchange rates was to be sought through the stability of underlying monetary and fiscal policies rather than by pegging; floating rates were to be subject to a process of surveillance by the IMF; the roles of gold and the dollar were to be reduced, with the SDR eventually becoming the principal reserve asset; and finally, the fixed official price of gold was abolished.

Since then, the international monetary system has evolved still further in order to keep pace with economic, political, and technological changes. As a result, we have witnessed a gradual departure from a regime of fixed exchange rates to a system of managed but relatively flexible exchange rates. Some would argue that this flexible regime has contributed to higher inflation and slower growth in GDP in the OECD countries over the past two decades, underlining the need for further multilateral cooperation. Though discussions on reform of the current system have been constant, a consensus has yet to be reached.

here," an inextricable link to the Bretton Woods experience remained, in spirit and reality. One must, in his view, answer the question "Did the Bretton Woods System succeed or fail?" by responding "Both."

The success of Bretton Woods enabled and reinforced an unprecedented expansion in world trade and payments over more than a quarter century. The Bretton Woods agreement led to the elimination of exchange controls and other restrictions in trade and payments and to the restoration of convertibility of currencies among major countries. It also established short-term credit facilities that proved to be an important source of assistance to countries in temporary balance-of-payments difficulties. These facilities still play an important role in today's system.

Daane cautioned that the same instruments that have been developed to cover risk and add liquidity and stability can also be used to speculate, leading instead to increased instability.

The Bretton Woods system failed, however, in three important respects, all relevant today. First, it failed to achieve an adequate adjustment process whereby countries would take the necessary measures, both external (for example, exchange rate actions) and domestic (mainly fiscal and monetary actions), to correct serious imbalances in their balance of payments positions. The Bretton Woods system failed in this because of its inability to ensure that countries would take these necessary corrective steps, an essential element in any effective international monetary system. Second, it failed to provide for the secular growth in world monetary reserves needed to accompany a growing world economy and a relatively fixed-rate system. Bretton Woods initially provided for expansion of borrowed reserves, but not for flexible additions to owned reserves. And third, Bretton Woods failed to provide means to cope with speculative capital movements, which time after time provoked an international monetary crisis.

Drawing on his personal role in the work of the Committee of Twenty (The Committee on Reform of the International Monetary System and Related Issues) to develop a blueprint for reform in the early 1970s, Daane described the four facets of an effective system from the perspective of that Committee: 1) a smoothly functioning adjustment process; 2) adequate liquidity, in terms of both borrowed and owned reserves; 3) a system that could deal with speculative capital flows; 4) a system that could accommodate the needs of developing countries. The Committee did not discard the idea of an exchange rate regime based on stable but adjustable par values, but it recognized that floating rates might provide a useful technique in particular situations.

Daane asserted that the history of the Bretton Woods agreement and the attempts at its reform contains lessons that are applicable today. It is no longer realistic to visualize a return to a relatively fixed-rate system in the Bretton Woods tradition, he declared, because the conditions for such a return are no longer in place. This became clear in the more recent difficulties of the European Monetary System, which was a microcosm of Bretton Woods. The question then becomes, how can we improve a system with floating rates and free (and instantaneous) capital movements? A glaring weakness in current monetary arrangements, according to Daane, has been the marked volatility of exchange rates. Yet the world has survived and prospered, and we may instead need a new concept or criterion of stability. Our earlier concept assumed that unstable exchange rates would be excessively detrimental to the growth of world trade, but this does not appear to have necessarily been the case.

A final lesson Daane drew was that the worldwide monetary system is now more vulnerable to the threat of systemic risk than it was at the time of Bretton Woods. He cautioned that the same instruments that have been developed to cover risk and add liquidity and stability can also be used to speculate, leading instead to increased instability.

The Views of Current Reformers

Charles Taylor considered the future of the international monetary system from the perspective of a modern-day reformer. He recalled that the founding fathers of Bretton Woods developed a cooperative, multilateral system, with the International Monetary Fund at its center to provide the advice and financing to help overcome international payments imbalances and to encourage the liberalization of international trade and payments. Although their par value system of fixed but adjustable exchange rates eventually broke down, in many respects their vision has proven both sound and durable.

Taylor traced recent monetary history and critiqued the present international monetary system from the viewpoint of the original Bretton Woods delegates. He imagined the delegates expressing surprise at the variety of financial services and financial instruments now available, the many types of financial institutions and the extent to which their activities overlap, and the sophisticated methods of management within these institutions. Other changes since Bretton Woods include the emergence of global markets, the growth in cross-border capital flows, and the displacement of credit markets by capital markets, along with the routine speed of transactions, the volatility of prices, and the emergence of sophisticated information systems. The delegates might also be surprised by the way in which the regulation of financial markets has fallen behind; by how ubiquitous uncertainty is; how ineffective fiscal policy has become; and how new and influential organizations like the G-7 and the European Community have sprung up alongside the IMF.

Taylor speculated that the Bretton Woods delegates would be troubled by recent economic performance in the OECD countries. Comparing the period from the 1950s to the 1970s, the days of the par value system, to the years that followed, Taylor noted that growth of real GNP declined and structural unemployment rose; the rate of growth in the trade of goods and services slowed while cross-border investment flows surged; and savings and investments as a share of GNP fell while public sector deficits grew, facilitated by the growth of international capital markets. One bright spot was inflation; "let out of the bag" in the early 1970s, it has been "squeezed back in again" since the early 1980s. Taylor attributed the poor recent performance overall to a general deterioration in fiscal policy, and to the occasional extreme currency volatility and misalignments of exchange rates that have recurred since the early 1970s.

Taylor noted the striking divergence between the increase in microeconomic efficiency in the international financial system and the decrease in the quality of overall macroeconomic performance. In the light of this disappointing record, he posed two questions: "How much of the problem is international in character and amenable to concerted multilateral action?" and "What are the public goods that can and should be provided through multilateral cooperation?" Taylor identified three such public goods: first, an environment that fosters efficient global capital markets. In the past, this entailed liberalizing payments and capital movements and establishing stable exchange rates. Now, however, limits on excessive volatility and persistent disequilibria must also be considered. Second, sustainable and coordinated macroeconomic policies. Fifty years ago, this meant macroeconomic policies compatible with the agreed exchange rate regime and with stable domestic prices. Today, longer-term structural adjustments must be undertaken to achieve this. Third, confidence in money and in the stability of financial institutions. In the past this was first and foremost a national responsibility: today this requires global cooperation in financial regulation, stretching beyond banks into other types of financial intermediaries.

Taylor noted the striking divergence between the increase in microeconomic efficiency in the international financial system and the decrease in the quality of overall macroeconomic performance.

The basic nature of the public goods needed today is similar to that of 50 years ago, but no consensus now exists on how to provide them. With regard to globally efficient capital markets, "financial libertarians" are at odds with those who favor some demarkation of acceptable limits to price movements, such as target zones for exchange rates. Many of today's policymakers can envision few alternatives to the present ad hoc approach to policy coordination, even though many outside observers would prefer more structure. Taylor attributed the current lack of consensus on global systemic issues to the fact that although substantial progress has already been made on the sub-issues using a pragmatic approach, our thinking about the subject as a whole remains at a relatively early stage.

Taylor expressed uncertainty on how the system will evolve. Existing problems in the international monetary system do give substantive reason for concern. The Bretton Woods Commission, the group of senior private sector individuals for which Taylor is the Project Director, will shortly publish its proposals for reform: They should be a major contribution to what looks like a vigorous public debate shaping up in the next few months.

The Role of International Monetary Collaboration

Richard Erb described the functions of the International Monetary Fund and the evolution of IMF surveillance, a now-routine process of international monetary collaboration among IMF members. The IMF Articles of Agreement state that "the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries and that sustains sound economic growth," a mandate that IMF surveillance seeks to carry out.

Following the breakdown of the fixed exchange rate regime in the 1970s, an agreement on a new regime could not be reached. The general consensus was that in order to reestablish exchange rate stability, it was first necessary to achieve "orderly underlying conditions" in those economic developments and policies that have a significant impact on a country's exchange rates. The need to focus on these "underlying conditions" led to the development of the collaborative procedure known as IMF surveillance. For each member, at least once a year, IMF staff conduct an in-depth examination of its economy, paying particular attention to monetary, budget, and exchange rate developments and policies, as well as labor markets and other structural areas. The IMF Executive Board assesses the results of this examination, which are then presented to the member's government. Analyses are also prepared for meetings of the G-7 countries, and twice annually the *IMF World Economic Outlook* is issued.

These surveillance consultations enable the IMF membership, through its representatives on the Executive Board, to assess if a country's underlying economic conditions can support sustainable growth, as well as domestic and external financial stability. Member governments generally accept the analysis of the Fund but are not obligated to adopt its recommendations. Often, it proves difficult to garner the necessary domestic political support to implement the recommended fiscal actions.

No limitations are placed on national sovereignty over economic policies and IMF surveillance seeks to influence member policies through good analysis and peer pressure. Erb believes that any effort to implement a fixed exchange rate regime in order to impose external discipline on domestic policies would receive a negative response from the IMF membership. This general attitude has not precluded regional efforts, however, such as the European Community's exchange rate mechanism, and much can be learned from them.

Erb went on to describe the spread of outward-looking, market-based reforms in both developing and formerly centrally planned economies, a development that will profoundly affect the evolution of the international monetary system. Over the years,

Erb noted that one byproduct of macroeconomic developments in Latin America, Africa, Eastern Europe, and Asia has been an increase in IMF membership from almost 150 countries in the late 1980s to nearly 180 today.

the IMF has assisted many countries' efforts to implement sound budget and monetary policies and to establish unified exchange rates and current and capital account convertibility. The positive economic performance of those developing countries in Asia that in the 1960s and 1970s chose outward-looking economic policies, combined with prudent monetary and budget policies, has encouraged other developing countries in Latin America and Africa to pursue similar policies.

In the late 1980s, a still more dramatic transformation began in many Eastern European and Asian countries with centrally planned economies. Their transformation has not been easy, but Erb expressed confidence that current macroeconomic and market-based reforms will shepherd these countries to high growth paths and eventually integrate them more fully within the larger world economy. One byproduct of all these developments has been an increase in IMF membership from almost 150 countries in the late 1980s to nearly 180 today, affecting both the framework of cooperation within the IMF and the evolution of the international monetary system.

The Role of Business and Government in Volatility

Scott E. Pardee observed how both business and government, in vain, desire a stable exchange rate regime. He believes that managed volatility is preferred even by those market participants who make their living betting on currency trends. Pardee recalled that when in October 1960 the price of gold broke out of the tight band set for it under the Bretton Woods system, he experienced the break as a profoundly moving event for the future of the international monetary system. Today, in contrast, similar shocks are frequent and violent, each one affecting the international monetary system and the profitability of any position he, or his company, may have in the markets.

In an international monetary system that works, according to Pardee, market participants who bet with the government should be the ones who make the profits, not those who bet against it. Unfortunately, some of the biggest profits to foreign exchange traders in recent years were made in 1992 and 1993 by those market participants who bet that the European Monetary System (EMS) would break down, and again in 1993 and 1994 by those traders who bet that the United States, in a fit of pique over Japan's trade surplus, would choose to jawbone the yen higher against the dollar. In contrast, market participants who bet that governments' stated policies would ultimately prevail, that the EMS would lead to greater exchange rate stability and that the United States would not manipulate exchange rates, sustained the largest losses.

In an international monetary system that works, according to Pardee, market participants who bet with the government should be the ones who make the profits, not those who bet against it.

Pardee defined two issues as central to the failures of the international monetary system since the end of the original gold standard, in the 1930s. First, when governments seek to stabilize exchange rates by setting par values or narrow limits of fluctuation for their currencies, they often hold out too long against market forces, leading to runs on the exchange market that they cannot control. Second, when governments adopt floating exchange rates, sooner or later they revert to unilateral dirty floating, depreciating their currencies to achieve domestic economic policy objectives.

Business and government have a strong desire for stable exchange rates for reasons of expediency: the existence of separate currencies results in an additional transaction cost for anyone making international payments. Volatility also adds to the cost of doing business internationally; the greater the volatility, the greater the cost until volatility itself may choke off the international flow of goods and capital. The expansion of the markets for swaps and other derivative products reflects the basic desire by many market participants to transfer volatility risks to others. Even those market participants who take these risks, however, prefer volatility that is reasonably predictable. An efficient international monetary system must provide broad, deep, and resilient markets for both cash transactions and for the whole array of volatility-driven derivative products.

Governments can achieve foreign exchange rate stability only in the nexus of conflicting domestic policy objectives. For governments that choose to fix their exchange rates with other currencies, determining when the exchange rate is or is not out of line becomes a discrete policy choice. When the market senses that a government is reviewing that policy choice, traders are quick to bet that the change will be made. To the extent that many traders jump on the same bandwagon, the amount of money they can move into one currency and out of another often makes their bet a self-fulfilling prophecy.

A government must manage its domestic affairs well if its exchange rate is to remain in a stable relationship with other currencies. Pairs of countries have managed this, but in each successful case, exchange rate stability came as a result of frequent and occasionally profound domestic economic policy adjustments, and after years of building up credibility in the marketplace. Democratic governments have a special problem in achieving credibility because their policies are actively debated in the marketplace. Financial officials have a continuing responsibility to keep debate within the government on track. Fixity of exchange rates remains a goal, but surveying recent monetary history, Pardee noted that the collapse of the Bretton Woods system in 1971–73 and of the EMS in 1992–93 is not an encouraging track record for the near future.

A monetary system can function efficiently only when confidence exists in the stability of its money as a unit of account and as a standard of value. When governments shake that confidence by manipulating exchange rates, they damage the system. Here, too, the record over the past 50 years has been discouraging, and the U.S. government has been the biggest culprit in currency manipulation. Recent Administrations have all succumbed to the arguments of U.S. industrialists and economists that other currencies should appreciate against the dollar. Such a policy has several drawbacks: It is inflationary for the United States, it causes foreign investors to shy away from buying American securities, and it invites retaliation by foreign governments.

Recommendations for the Future International Monetary System

In the near future, the international monetary system must be protected against possible internal breakdowns to reduce risks to the system as a whole. The economic and technological challenges posed by new markets, the information superhighway, the proliferation of derivative products, and other changes will be profound. Governments must pursue effective stabilization policies, sustaining growth with a minimum of inflationary pressures and avoiding excessive trade or capital account imbalances. The international monetary system needs new leaders of vision, like those at Bretton Woods, the founding of the European Payments Union, the European Monetary System, or even Maastricht, to shape its institutions. Although the Bretton Woods delegates may have been parochial in their insistence on details that favored their national interests, what emerged was a collective, coherent view of the international monetary system as it should be. More recent agreements have lacked this insight.

Pardee concluded by reflecting on the writings of William McChesney Martin, a former Chairman of the Federal Reserve, on the possibility of a world central bank. Although it probably could not be achieved under the nation-state political system, Martin's vision could provide an important sense of direction to the international monetary system, an alternative to confronting each monetary crisis as it comes.

The Importance of Domestic Fiscal Responsibility

Stefan Schoenberg noted that the entire globe may soon be included in the international monetary system. Throughout his presentation he emphasized that in a world of fully integrated financial markets, currency competitiveness was very much tantamount to policy competitiveness. In this context, he stressed the importance of domestic fiscal responsibility in maintaining exchange rate stability. Any international monetary system or "order" must provide answers to the following basic questions: 1) To what extent are international transactions liberalized or subject to controls? 2) How are exchange rates determined? 3) Which currencies function as "international money" (that is, as reserve, investment, intervention, and transaction currencies)? 4) Through what mechanism is international liquidity supplied?

Countries that want to benefit from free capital movements must accept impairment of their economic policy sovereignty, according to Schoenberg.

Schoenberg noted that the founders of Bretton Woods proposed that the freedom of international capital movements take a backseat to the objective of fixed exchange rates, and they limited their aims to removing restrictions on current transactions. Today, in contrast, we are confronted not only with a global market for goods and services but, increasingly, a global financial market as well. Countries that want to benefit from free capital movements must accept impairment of their economic policy sovereignty, according to Schoenberg. Large changes in capital flows can make domestic policymaking difficult, but attempts to discipline that market will fail, since it is impossible to distinguish between "good" and "bad" capital transactions. Analysis undertaken by the IMF indicates, however, that most of the policy changes forced by international capital markets seem to have been in the right direction.

Schoenberg claimed that the present "non-system" remains the only functioning solution to the determination of exchange rates at this time. A fixed-rate system would threaten the autonomy of economic policies which the major industrial countries want to preserve, despite all their cooperative efforts.

Countries that intend to maintain a fixed exchange rate system at the regional level, such as the European Monetary System, must acknowledge that to do so requires at least partial surrender of policy autonomy.

Current problems with volatility and misalignment of exchange rates can be settled, in the long run, only if major industrial countries pursue a consistent and credible economic policy that can stabilize the expectations of market participants, and thus reduce exchange rate fluctuations. To the extent that national economic policies are undisciplined or ineffective, or lack consistency in policy objectives, efforts to maintain exchange rates will lack credibility, leaving room for significant swings in nominal and real exchange rates.

The international monetary regime will doubtless remain a multicurrency system for some time, Schoenberg declared. With the decline in the international use of the U.S. dollar since World War II, other currencies, most notably the deutsche mark and the yen, serve as nominal anchors in their respective regions. A future international monetary system may be multipolar, with "loose" exchange rate commitments between the poles and "tighter" commitments by some of the countries around the poles. The availability of alternative international currencies has a strong advantage over the postwar Bretton Woods dollar-based system, in so far as it stimulates beneficial policy competition between the various anchor currencies.

A national currency used as "international money" must be convertible in terms of both current and capital transactions. There must be confidence in the stability of the currency and the policies of the country that issues it, and financial markets must meet investors' needs. The U.S. dollar remains, by far, the most significant reserve and investment currency and it plays an outstanding role as a transaction currency for international commodity trade and in foreign exchange transactions. The deutsche mark owes its status as the second most important currency primarily to its above-average stability. The deutsche mark functions both as an anchor in the EMS, providing interest rate leadership, and as the main intervention currency in both EMS countries and in non-EMS countries linked to the EMS. In contrast, despite Japan's growing importance as an exporter of goods and long-term capital, its payments practices with neighboring countries and their official reserves show that a distinct "yen zone" does not yet exist. Therefore, the formation of a symmetric tripolar world monetary system remains some time off. According to Schoenberg, market forces will continue to determine how the international monetary system develops, as they have for the past two decades.

Concerns about international liquidity, Schoenberg's final question, now relate more to its distribution than its adequacy. The supply elasticity of the markets has proven generally adequate to satisfy any justified global demand for reserves. Earlier concerns that led to the creation of the Special Drawing Rights system did not materialize and are unlikely to do so in the future. The fact that many countries do not have access to private sources of liquidity or must pay higher spreads when borrowing in international financial markets reflects mainly past economic policy failures. High costs in borrowing reserves thus serve as an indispensable indicator of the need for macroeconomic policy changes. In Schoenberg's opinion, governments or international institutions would not make more rational decisions about credit allocation than the market.

Schoenberg concluded with comments on the future of monetary policy in Europe. In 1999, European Union member countries deemed mature enough are to form a monetary union and introduce a common currency. Market behavior has made it rudely clear over the past 18 months, however, that a long road remains to the achievement of a single currency in Europe. Institutional arrangements must be in conformity with the market's assessment, because if the two clash, market forces inevitably prevail. For too long, financial markets fixated excessively on the final goal of European monetary union, mistakenly assuming that the success of future convergence efforts could be predicted by fixing exchange rates. To regain their credibility, European Union central banks must recognize that improving convergence is a long-term job requiring the coordinated action of all member states, not solely an exchange rate constraint.

Conclusion

In their remarks and in the discussion that followed, each speaker agreed that a return to a fixed-rate system, as envisioned by the founders of the Bretton Woods system, is not possible today given the changes in underlying economic conditions since that time, in particular, the high degree of integration of financial markets. Each examined the damaging effects of fiscal imbalance and volatility on current regimes, both floating and relatively fixed, such as the European Monetary System, and as a result, on the world economy. Daane remarked that unstable exchange rates have not been excessively detrimental to the growth of world trade, however.

To limit volatility, Schoenberg, Pardee, and Taylor emphasized the need for better fiscal policy, stable exchange rates, and consequent domestic policy compromises. Schoenberg pointed out that a stable international monetary system requires that institutional arrangements coincide with market expectations. Along similar lines, Pardee remarked that market participants who bet with governments should profit, not those who bet against them, as has recently been the case. Erb stressed the importance of IMF surveillance to encourage responsible fiscal policy by IMF members and, thus, limit volatility. He focused, uniquely among the speakers, on the important role that developing economies in Asia, Latin America, and Africa, and the formerly centrally planned economies in Eastern Europe will play in the international monetary system in the near future. Pardee and Taylor alluded to the possibility of institutional reform in the near future, with Pardee advocating a world central bank as a possible long-term goal for present reform efforts.

All agreed that different arrangements will emerge by which individual countries can choose, through formal or informal reciprocal agreements, to peg their currencies to one another, eventually creating clusters of linked currencies. This process may lead to a more stable, multipolar international monetary system in the twenty-first century, with several currencies acting as anchors in their respective regions, a possible future implementation of the original goals of Bretton Woods.