Multilateral Surveillance and Macroeconomic Policy Coordination: Designing an Appropriate Framework

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As the global crisis moved away from an immediate emergency phase, world leaders at the G-20 summits turned to long-term issues. The basic idea launched in Pittsburgh was that international collective action could put the international economy on a stronger, more balanced and sustainable growth path. They trumpeted the creation of a new framework based on a Mutual Assessment Process. This article emphasizes the need of international coordination of economic policies, argues that too little has been achieved in this regard, explains that insufficient attention has been paid to the institutional base of the Mutual Assessment Process and offers proposals for a more efficient framework.

The Risks of Inadequate Macroeconomic Policy Coordination

International economic policy coordination is a challenging and frequently disappointing task. This is possibly one of the reasons explaining why many macroeconomists are comfortable with the idea of uncoordinated economic policies, in particular when economies are in genuinely different situations; if growth potential, unemployment, balance sheets and/or other parameters are materially different, it is not only comprehensible but desirable for macroeconomic policies to differ. It is thus a frequent argument that each government doing what it thinks is best for its own economy (the U.S. fighting excessive unemployment, Europe cleaning its own problems, China "reorienting" growth) is the most appropriate contribution to the common good. This argument can provide some comfort to international inaction. Unfortunately, in a deep crisis, things are more complex and inaction should not be an option.

Global interdependencies on the products and capital markets have proved strong and these interdependencies generate spillover effects likely to produce undesirable outcomes if unproperly managed. Tightening governments, for example, expect to gain on net exports by relatively constraining costs, income, indebtedness and demand in comparison to their trading partners. Monetary divergences as well have counter-productive consequences. Capital flows might amplify the consequences of asymmetric policy moves. Above all, global imbalances remain a Damocles' sword hanging on the future of the global recovery.

The fear of the great recession turning into Japan's lost decade or worse into a new great depression has until now been averted but the risks facing the world economy are not eliminated. Current policy discussions within the G-20 framework probably underestimate the relevance of these parallels for understandable reasons. In short, euro-area policymakers could, under German inspiration and influence, exaggerate the benefits of a principled austerity; following decades of benign neglect regarding debt, American policymakers could underestimate the coming limits of global investors' willingness to finance U.S. tax and monetary profligacy; and China could wrongly assess the permanence of open export markets in face of its continuously increasing surpluses. "Macroeconomic policy wars" cannot unfortunately be considered as things of the past. This paper argues that academics should properly assess these risks and policymakers should act and try harder to definitely avoid them.

Informal Coordination Not Sufficient for Growth Management

The creation of the G-20 has undoubtedly been an appropriate answer to the financial crisis and it proved a useful framework to design urgent measures. Following a successful but fragile recovery, the challenge for the G-20 is to shift from a crisis management status to sort of a global steering committee. The G-20 probably has the potential to exercise this sort of leadership. But the challenges are many; there are the questions of legitimacy, the articulation with other international fora and the issue of effectiveness, among many others. Since the G-20 has rightly been characterized as the "premier world economic forum", many of these questions will be cut according to its success in attaining its proclaimed goal of a "strong, balanced and sustainable growth". However, recent summits have been disappointing in this regard.

There is an understandable agreement to avoid contentious and unproductive debates within the G-20. But when using pragmatism leads to eliminating imbalances and exchange rates from the agenda even at the level of the finance ministers, and when communiqués barely mention the issue, one can argue that the process is not up to its task. In the new science of "summitry", it is interesting to observe what a difference this situation makes with the beginning of the G-7 meetings, whose primarily role was precisely to organize a conversation on the same sort of issues. There is little doubt that the successful role of the G-7 regarding financial and monetary issues proved a very important starting point which at that time gave its legitimacy to this restricted group. Bluntly speaking, the Toronto or Seoul summits did not pass the same test. Concerns over the conflict between short- and long-term objectives dominated the debate on fiscal consolidation. In place of a disciplined and informed conversation on international monetary affairs, we have witnessed a theatrical scene starting a new "currency war". Rhetoric and saber-rattling are no contribution to a stronger and more balanced growth.

The Indicators and Their Processing: A Bigger Role for the IMF

In the fall of 2010, U.S. Secretary of the Treasury Timothy Geithner suggested adopting a common view on what was a desirable range for current account surpluses and deficits. The proposal was badly received and considered as aggressive by surplus countries. The Seoul Summit nonetheless ended with an agreement to have the G-20 framework group produce a set of indicators that would help in evaluating what is an unsustainable current account. Despite its apparent modesty, this goal proved difficult to attain. The selection of this set of indicators has been narrowly and unenthusiastically fixed at the meeting of G-20 finance ministers in Paris in February 2011. One can say "it's a first step"; the reality is that the progress is extremely modest. After all, these indicators are well known and publicly available. What is needed is the indicators gaining more voice! Whatever their choice, and subsequently the models that will serve for analytical purposes which by experience will constantly be a work in progress, emphasis should be put not on the surface but on the substance of policy coordination.

Global imbalances today are supersized when compared with previous ones and could potentially pose greater threats to financial stability than in the past. Their correction will require long lasting efforts which will weigh on both sides of the economic equation, a reallocation of global savings and demand, and the implementation of important structural reforms. There is a need not only to agree on a one-shot correction of macroeconomic policies but on the definition of a new trajectory. This requires a common understanding of the economic outlook and a convergence in the manipulation of policy tools. Multilateral surveillance as embedded in the Mutual Assessment Process is not enough; informal coordination of macroeconomic policies, as embedded in the framework, is not enough. If they are really willing to deliver more sustainable growth, leaders should be willing to reach analytical agreement and policy conclusions.

The preparation of the summits should be put within a more formal and demanding process. What follows is a suggestion to act in this direction.

The core of such a formal process of economic policy coordination is the International Monetary Fund. Its proper role has been debated for years; before the economic crisis, the IMF was even dismissed as a "firefighter without fire". The IMF's legitimacy has been contested and there was a clear need to put its shareholders' structure and governing bodies more in line with the realities of the 21st century. Now, things have changed. Backed by its recognized technical competencies, the IMF is a significant contributor to the work of the G-20, in particular with the early warning exercise and G-20 surveillance notes. But the world could and should make more productive use of the International Monetary Fund. This is the place where the three steps—indicators, surveillance and coordination—should mix into a real policy decision process. This requires a reflection on its mandate and governance.

Political Will Should Be Expressed in a Stronger IMF Mandate

Every international institution works according to the agreement of its participating nations enshrined in its mandate. But make no mistake, this seemingly clear expression is misleading. One should distinguish a political mandate, which is expressed in broad, ambitious sentences, and the legal content, whose restricted terms are the basis of the institution and the only real definition of its powers. For example, the IMF has articles of agreement that read as very broad goals in relation with the above discussion. Article 1.6 reads as follows: "the purpose of the IMF (is)… to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members". This was and remains a perfect political goal except that the IMF in the present circumstances has no tool to make it happen. For example, the former managing director of the IMF, Rodrigo de Rato, launched a multilateral surveillance exercise pursuing this goal, but never got any traction. Politically speaking, the mandate is clear and appropriate. However legally speaking, member-nations have very few obligations to reach the common goals they have subscribed to and this is what has to be changed.

An important and preliminary question is whether it is necessary to change the IMF's articles. A careful legal investigation of the issue by the IMF's general counsel concluded that much could be done within the existing articles; that's fine because any attempt to change the articles would probably be a recipe for failure. There is a possibility for the IMF board to adopt an "organic decision" which would for example give a sharper expression to the present article 4.3a: "The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations". Following the financial crisis, the Fund organized a vast series of consultations in order to improve its ability to monitor the international financial interdependencies, going far into the direction of scrutinizing major financial institutions. The suggestion here is rather that the IMF should focus its ambitions on its core business, current accounts and exchange rates. An effective multilateral surveillance process will not work until an agreement is reached to give more expertise, voice and power to the IMF, which means translating this goal into legal obligations for its members.

Embedding International Economic Policy Cooperation

The G-20 summits are prepared by finance ministers' meetings. This creates sort of a duality with the International Monetary and Financial Committee (IMFC), the finance ministers' gathering as tutors of the IMF. This duality needs to be clarified. The governance of the IMF has been extensively discussed according to the question of shares and chairs. This is an extremely important issue and hopefully significant progress has been made even if more remains to be done. But the reality is that these changes, as desirable as they are, will not make the solution of global financial problems easier. A new step forward is needed to more effectively exercise multilateral surveillance at the top of the International Monetary Fund. This is why an effective policy coordination process requires the transformation, as expressed in the statutes of the IMF, of the feeble existing IMFC into a politically responsible council.

The Manuel Report recently revived this old suggestion which has always attracted criticisms from different quarters. Joseph Stiglitz, for example, recently complained that the proposal did not go sufficiently far in the redistribution of power in favor of developing countries. On the other side, Barry Eichengreen mocked the idea of changing the name from IMF Committee to IMF Council, both being in his views synonymous with ineffectiveness. Both criticisms are debatable but fall short of measuring the issue at stake. Remember that one of the origins of the G-7 in the context of an already troubled financial world in the 1970s was precisely the ineffectiveness of the committee and the need to have a meeting of officials at the ministerial level, more able than the executive directors of the IMF, to make decisions and seal agreements. This was why the G-7 finance ministers' meeting has taken place for years the day before the formal IMF Committee. This settlement today is anachronistic. It would be unwise to duplicate the G-20 or 24 finance ministers acting at the head of the IMF with a G-20 finance ministers group working for the leaders. The same reasons, which made the creation of the G-20 leaders meeting necessary, require the empowerment of the previous G-20 finance ministers group. This is why the solution to reconcile legitimacy and effectiveness is to reform the governance of the IMF and to create a politically accountable council.

The new council would have explicit powers regarding the strategy of economic policy coordination and its first task would precisely be multilateral surveillance. The skeptics will immediately ask why this arrangement should be more efficient than the existing ones. No doubt, there is here an element of betting which can be expressed in the following way. The fact that surveillance did not work in the past does not necessarily mean that nations reject collective discipline. The example of the World Trade Organization and its Dispute Settlement Body is proof of the contrary. This example rather suggests that informality is enemy to effective policy coordination. The political economy of international relations can easily support the view that nations will reluctantly adhere to informal policy coordination mechanisms; the benefits raised from a flexible framework are more than offset by the costs of an unpredictable course of events. This is why this proposal relies on a more explicit definition of the obligations of IMF members and gives more powers to the council to exercise surveillance.

The council naturally supervises the activity of the IMF and makes strategic decisions regarding the major programs and the launch of new initiatives; without starting here a discussion on the special drawing rights, the council would clearly have big responsibilities should any progress on this issue be the fruit of an improved international economic cooperation. The creation of the council would change the architecture of powers at the head of the IMF. The executive board would be transformed into a permanent representation of the ministers and would lose its responsibilities in the day-to-day management. Conversely, the managing director would enjoy greater independence. In a figurative sense, the managing director could be the voice of the indicators; he would be the guardian of the principles to which the governments have subscribed, he would pressure his council to act cooperatively and he would to report to the G-20 summit so that better international economic policy coordination could really happen.

Conclusion

The G-20 has been a quick and efficient answer to the immediate risks involved by the eruption of the financial crisis. The challenge now for this summit is take on its responsibilities as the "premier world economic forum". Its defining challenge is to design a credible path toward "strong, balanced and sustainable growth". The Toronto and Seoul summits proved rather disappointing in this regard. The Mutual Assessment Process and the introduction of a series of "indicators" definitely appear as insufficiently sharp. This paper argues that the world needs a formal framework for developing a more efficient economic policy coordination, that this process should be centered on the IMF, and that a few conditions can transform multilateral surveillance into a better policy decision-making process. These proposals can be received with skepticism because the obstacles to international collective action are well known by experts and government officials. A more positive view can nonetheless be backed by the spirit of international cooperation, by the fact that this political will is deeply rooted in huge interconnected economic interests and by the fact that the perils of a Japanese style lost decade or of a new great depression cannot assuredly be considered as past. This is why it is useful to build on previous stages and to recommend to "give more voice to the indicators".