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Global Imbalances and Capital Flows in the Era of New Technologies

Opening Remarks - Banco de España and the Reinventing Bretton Woods Committee

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Ladies and gentlemen, I am delighted to welcome you to this conference on global imbalances and capital flows in the era of new technologies. The Banco de España is particularly honoured to be co-organising it in collaboration with the Reinventing Bretton Woods Committee on the 75th anniversary of the Bretton Woods agreements.

Indeed, an anniversary to celebrate, and a unique opportunity to praise the merits and achievements of the rules-based system set by these agreements. But it is also high time to reflect on the challenges facing our current framework of global economic governance inspired by the agreements.

The core values of multilateralism and international cooperation that guided the Bretton Woods agreements in the past, are at least as necessary today as, with hindsight, they were 75 years ago. Admittedly, the world has changed rapidly and profoundly. In such an evolving context, some "tailoring" to update international economic governance may be warranted, precisely to ensure that the core values that have promoted international cooperation will continue to do so in the future.

In particular, over the last few decades we have been witnessing the emergence of new economic, political and geostrategic powers, as well as new challenges: population aging, migrations, security threats, social inclusion, and climate change, to name just a few. And all these dynamics have been taking place in an era of digitalisation and rapid development of new technologies, in which massive information flows call for an internationally agreed response that allows the benefits of innovation to be reaped while ensuring that the potential risks are mitigated.

Together, these developments amount to a new policy frontier that requires the promotion of mutual understanding and broad coordinated policy efforts, in much the same way as when the world first confronted the problem of managing increased trade and financial flows.

However, this need for further coordination comes at a time when inward-looking populist and protectionist policies have re-emerged in some countries in combination with a greater emphasis on bilateral relations, somewhat questioning the current multilateral rules-based framework.

I am certain that all these topics will feature highly in our discussions over the next two days. But before opening the full conference, allow me to start by recalling the underpinnings of the Bretton Woods agreements, the economic benefits they have facilitated and the limitations that have become apparent over the years. I would then like to discuss why reforms are key to the survival of multilateralism, with some ideas for a way forward to tackle current challenges in an increasingly interconnected and digitalised global economy.

The benefits of multilateralism

The Bretton Woods agreements of 1944 were the cooperative response to the unilateral actions taken in the early 1930s that led to a period of historic global economic contraction. To quote Anne Krueger, this episode is an excellent example of how "efforts to depart from multilateralism have provided more vivid illustrations of the need for multilateral solutions to international economic policy issues”.[1]

Ever since the signing of the Bretton Woods agreements, international cooperation has focused on creating a system governed by generally accepted rules. These have been complemented by mechanisms and procedures to ensure compliance and to resolve potential conflicts on the basis of fairness and equity from the perspective of all member states. In this rules-based system, multilateral organisations play a key role, by promoting the transparency and predictability of the system and by seeking to limit free-riding.

There is a broad consensus that this system has been key to the development of globalisation and the promotion of economic growth and prosperity for many countries over the past half century.

Trade barriers were drastically reduced and trade flows soared. According to the WTO, between 1948 and 1993 the value of world merchandise exports increased from $59 billion to more than $3,000 billion; and they jumped to five times that figure after the creation of the WTO. More importantly, in 1948, 63 percent of those exports were traded by Western Europe and the US, by 1993, this percentage had decreased to 58 percent and in 2016 it reached 48 percent, with a major shift in flows towards Emerging Asian countries.

At the same time, financial flows were gradually liberalised and a global financial system emerged, with the active participation of global banks and investment firms. In addition, foreign direct investment inflows have increased tenfold since 1993.

The opening up of the current account and the subsequent expansion of trade and financial flows enabled many countries to raise their development status. In this vein, GDP per capita in low and middle income countries doubled in constant terms from 1995 to 2016, while extreme poverty was notably reduced.

The Spanish experience since the mid-1980s, when we joined the European Union, constitutes a canonical example of the benefits that the opening up and liberalisation of an economy can bring about in terms of growth and economic modernisation.

The need to reform the global governance model

However, we should admit that the multilateral system that emerged from Bretton Woods has been sluggish in adapting to a changing world. A world in which emerging economies play a greater role in the global economy than they did in the past. This has undermined some of its legitimacy, causing disaffection among some of its members and impairing the consensus needed for agreements to be reached at international level.

The emergence of the global financial crisis in 2008 highlighted the need to rebalance representation on global fora in order for effective concerted action to be achieved. This led to the endorsement of the **G20** as "the first forum for international economic cooperation".[2]

[1] Anne Krueger (2007), “An enduring need: multilateralism in the twenty-first century”, Oxford Review of Economic Policy, Volume 23, Number 3, 2007, pp.335–346.
[2] G20 Pittsburgh Declaration, September 2009.

Indeed, the new framework proved to be key in containing the effects of the global financial crisis, through multilateral and coordinated actions on the monetary and fiscal fronts. The protectionist response to the crisis was significantly smaller than during the Great Depression. In addition, since 2009, the G20 has promoted a range of policies to enhance the resilience of the global financial sector, including stricter prudential requirements for internationally active banks and, particularly, for systemically important institutions.

However, after the initial impetus provided by the G20-multilateralism, finding consensus at international level has become increasingly difficult over time and the initial hopes that the G20 could become an effective mechanism for coordinating national policies have faded somewhat.

Against this backdrop, it seems clear to me that the way in which international cooperation is defined and multilateral institutions work need to be revised.

The **system of global trade** is a paradigmatic case, given the broad consensus on the need to reform and revitalise its backbone, the WTO.[3] While some western economies raise concerns about China's trading practices, as well as the effects of its industrial and technology policies on the level-playing field, many emerging countries complain about western countries' policies in areas such as agriculture.

Not only has the WTO proved unsuccessful as a forum for solving these issues, but also progress in responding to the challenges posed by the emergence of new forms of trade, such as e-commerce, has been rather limited. The experience in other relevant areas such as investment, intellectual property protection and public procurement, has been similar.

Indeed, the collapse of the Doha round in 2001 had already raised doubts about the WTO governance framework. In particular, the effectiveness of the Dispute Resolution System and the viability of conducting trade discussions and adopting decisions involving over 160 countries, on the basis of general consensus, had been called into question.

In fact, given the deadlock in WTO negotiations, countries have chosen to shift their liberalisation efforts towards regional or bilateral agreements. However, it is important to stress that bilateral agreements represent only a second-best solution. They usually entail some form of trade diversion which, from a global perspective, reduces the positive effects stemming from trade creation.[4] What is more, bilateral or regional agreements, give rise to situations in which large trading nations or blocks are typically in a stronger negotiating position than other economies, generating an asymmetric system of international relations.

And, in this context, a trade war has unfolded, which is already taking a heavy toll as regards its effects on global trade and global uncertainty and is currently one of the greatest threats to the world economy.

[3] Hoeckman (2018), "Revitalizing Multilateral Governance at the World Trade Organization", Report of the High-Level Board of Experts on the Future of Global Trade Governance. https://cadmus.eui.eu/handle/1814/60580
[4] Dai, Mian, Yoto Yotov and Thomas Zylkin (2014), "On the trade-diversion effects of free trade agreements", Economics Letters, 122(2): 321-325.

On the financial front, the **international architecture** has also become more fragmented during the last decade. The difficulty of reforming the IMF´s governance structure and the impression that its resources might prove insufficient should a severe crisis occur, have contributed to the emergence of multiple layers in the global financial safety net.[5]

Since the global financial crisis, the system has expanded to encompass multiple forms of insurance, comprising the IMF and a number of regional financial arrangements (RFAs) — the size of which has increased from almost negligible amounts in the early 2000s to more than 1.5 trillion dollars today —, bilateral swap lines and reserve arrangements.

The proliferation of regional financial agreements is a response to countries' need to ensure access to support for their balance of payments when circumstances require it — in some cases subject to less strict conditionality, in an effort to avoid the IMF stigma —, but also to the need to boost resources for crisis prevention and resolution. The latter need is clearly the rationale for the largest RFA, the European Stability Mechanism, created in the middle of the euro area sovereign debt crisis.

As a result, the global financial safety net has expanded beyond the walls of the IMF with limited coordination across its different layers.

In short, the multilateral system has given way to a new decentralised and fragmented system, more prone to bilateral conflicts and managed by informal, non-binding commitments.

Reform is possible

It should come as no surprise that without reform, the current system will be unable to provide satisfactory answers to global problems, to address externalities caused by unilateral actions, to ensure the enforcement of international (non-binding) agreements or to confront free-rider concerns. In other words, in the current context of new powers, new economic and geopolitical equilibria, and new challenges, multilateralism has to be adapted to ensure its survival.[6]

These reforms should be pragmatic. Viable solutions should first aim to **establish frameworks that ensure the best feasible agreements are reached, implemented and enforced**. The idea would be to support collective action in specific fields through various existing multilateral fora that are already working effectively. There are good examples of this course of action in the financial stability arena as shown by the work of the Financial Stability Board[7] or the Basel Committee on Banking Supervision.

A similar model of collaboration could perhaps be tailored to the trade arena to unblock the WTO.[8] That should allow progress on multilateral agreements, despite blocking positions in the current institutions. In this case, flexibility means the possibility of third parties voluntarily

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[5] Garrido, I., P. Moreno and X. Serra (2012), "El FMI y los acuerdos regionales de financiación", Boletín Económico, March, Banco de España, and (2016), "The new map of international financial institutions", Economic Bulletin, January, Banco de España.

[6] Johannes Linn (2018): "Recent threats to multilateralism", Global Journal of Emerging Market Economies 9, 86–113.

[7] https://www.bundesbank.de/en/press/speeches/policy-evaluation-assessing-the-effects-of-post-crisis-financial-sector-reforms-799146

[8] https://www.imf.org/en/Publications/Policy-Papers/Issues/2017/07/31/pp073117-collaboration-between-regional-financing-arrangements-and-the-imf

adhering to a plurilateral agreement in due course (making the agreement multilateral in essence), while maintaining peer pressure to avoid free riding.[9]

Furthermore, **the new global governance system should recognise that both regionalism and multilateralism are compatible**, as some problems are of a local nature and are better tackled locally. Regionalism and multilateralism are not mutually exclusive. On the contrary, both approaches can support and complement each other, generating synergies that strengthen the global financial safety net. Indeed, bilateral and regional agreements have in many cases brought about improvements in the multilateral trading system. E-commerce is a good example of this.[10]

In this regard, the European Union, for example, should maintain its proactive approach to preserve the rules-based global trade system. And indeed the European Union is fully engaged in working, together with other members, on proposals to strengthen the WTO in areas such as subsidies, e-commerce, property rights and ensuring enforceability of existing WTO commitments with a well-functioning dispute settlement system that cannot be blocked by any single country.[11] At the same time, it is important that the European Union should continue to negotiate trade agreements with other partners. Although, as mentioned earlier, this is not a first best solution, it is time to recognise that regional and multilateral arrangements open to others can succeed where multilateral negotiations have failed to bring many countries into the international trading system.

In the **financial arena**, the emergence of regional initiatives has generated a more robust and better resourced global financial safety net. However, coordination between the different layers should be strengthened, on the understanding that a regional system can complement, but not substitute, the role of the IMF. In my view, the IMF is still essential, for at least four reasons. First, it has unique expertise in crisis management. Second, the participation of the IMF in adjustment-programme design adds an objective view that regional institutions cannot provide, one that is respected both by domestic authorities and by the private sector. Third, in cases of interconnected economies, the involvement of the IMF can dissipate the potential regional concentration of risks. Fourth, the IMF is the only institution that can mobilise a substantial amount of resources should a global crisis occur.[12]

Finally, I believe it is also important to make the multilateral system and its benefits more visible to the general public in order to regain legitimacy and public support. In this sense, global integration should be accompanied by domestic policies that allow all citizens to reap the benefits of globalisation, since although the general equilibrium effects of globalisation are indeed positive, it can have negative effects on certain sectors and groups, which it is important to try to minimise.[13]

Many of these ideas may well fit into what former IMF managing director Christine Lagarde dubbed “new multilateralism in a new economic landscape".[14] She illustrated her proposal

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[9] http://trade.ec.europa.eu/doclib/press/index.cfm?id=1945

[10] Alan WM. Wolff (2019), “The opportunity for reform of the trading system must not be squandered”, Speech at the Banque de France conference centre in Paris, 16 July 2019.

[11] http://trade.ec.europa.eu/doclib/press/index.cfm?id=1945

[12] Gallego, S., P. L’Hotellerie and F. López (2018), “The International Monetary Fund and its Role as a Guarantor of Global Financial Stability”, Banco de España, Economic Bulletin 4/2018.

[13] IMF (2007), “Globalization and Inequality”, WEO, Chapter 4 and Helpman, E. (2018), “Globalization and Inequality”, Harvard University Press.

[14] https://www.imf.org/en/News/Articles/2018/10/11/sp101218-new-economic-landscape-new-multilateralism

nicely with two examples. One concerns trade integration: the system should be fair and take care of those left behind in the process of globalisation. The other relates to global imbalances: deficit and surplus countries should both take action in a cooperative manner. Again, a core element of any of these proposals is complementarity between sound domestic policies, international cooperation and a robust global financial safety network that accommodates both regional and multilateral actors.

Conclusions

In short, the multilateral economic cooperation system, despite its limitations, has allowed significant development in many countries over the last few decades. Today, more than ever, its defining principles of cooperation, rules, universality, formality and sovereign equity need to be preserved to enable the various global challenges ahead to be addressed.

Notwithstanding this, the new economic, social and geopolitical realities call for a reform of multilateralism. We must work to adapt multilateral institutions to the new realities, eliminating obstacles that hinder collective action, making them more flexible, efficient, representative, transparent and accountable. They also need to become more cooperative and to better complement regional arrangements and institutions.

Thank you.