1. Introduction

By

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For more than three decades, the Bologna–Claremont Monetary Conferences have generated lively and engaging debates on international monetary policy. Academics, bankers and officials from all over the world have discussed the most important issues at the forefront of international monetary policy and debated prospects for reform. This volume reports the proceedings of the Bologna–Claremont conference held in March 23–25, 2000 at the Johns Hopkins Center in Bologna, Italy.

The first conference of the series was held at the Bologna Center in 1967. Its inspiration stemmed from the problems arising from the precarious state of the gold-anchored fixed exchange rate international monetary system that had served the world economy in the post-war decades. Major exchange rates were fixed to the US dollar, which in turn was convertible into gold. But price levels in all the major countries had soared during and after World War II, the Korean War and the Vietnam War, while the dollar price of gold had been maintained at \$35 an ounce, originally set at this rate in 1934. As gold became scarce, countries turned to using dollar balances in lieu of gold for international payments and reserves. But the buildup of dollar balances created new problems as its convertibility into gold became increasingly questionable. Shifts in central bank portfolios led to a drain on the US gold stock and speculation, putting the international monetary system in jeopardy. The international monetary system seemed to be stuck on the horns of a dilemma, first identified by the Belgian economist, Professor Robert Triffin of Yale University: If the US did not correct its balance of payments deficit, there would be a convertibility crisis; but if it did correct it, the world would run short of reserves and bring on global deflation like that in the 1930s. The system did break down, and the failure to find a way to negotiate a restoration

of the system led to the ratification of a regime of fluctuating exchange rates in the 1970s.

Fluctuating exchange rates of course did not solve the inherent problems of the system. Under fluctuating exchange rates, the dollar retained a key role in international payments as unit of account, invoice, intervention, and reserve currency. Problems of the US deficit were replaced by problems arising from the dollar cycle. The weak dollar of the late 1970s was replaced by the strong dollar of the early 1980s and the weak dollar of the early 1990s, only to be replaced again by the strong dollar associated with the IT revolution and the weak dollar of the global slowdown that started at the end of the decade. Over much of this period, many countries resented the unique role of the dollar in the system and worked to create zones of fixed exchange rates outside the dollar area. The most spectacular of these new currency areas is the euro area. The euro came into being in 1999 and was a major issue of discussion at the Bologna conference and is so in this book.

The advent of the euro was, arguably, one of the most important monetary events of the twentieth century. With its very creation it became the second most important currency in the world. Within the euro area, it gave every individual a more important currency than he or she had before, every firm a global capital market, every country lower interest rates and it created for the monetary area as a whole a purchasing power parity area that had been only partial even under fixed exchange rates. For the world as a whole it created an alternative to the dollar in case the dollar became unstable and an alternative global currency in which to hold foreign exchange reserves. Perhaps most important of all, it created a change in the power configuration of the system, a movement away from a polarized world economy dependent on the dollar to a multipolar world of large competing currency areas.

In recent years the three largest currency areas – the dollar, euro and yen areas – have been characterized by a remarkable degree of price stability coupled, paradoxically, with a high degree of volatility and even instability of the major exchange rates. Unfortunately, with increased decentralization of power, there has been a noticeable absence of leadership stressing the need for cooperation and multilateral management of interdependence. One issue that arises again and again is whether there is any possibility of creating a truly global currency along the lines of the early American and British plans prepared for discussion at the Bretton Woods conference 60 years ago. Paul Volcker,

the eminent Chairman of the Federal Reserve System in the 1980s has argued persuasively that “the global economy needs a global currency.” Whether or not that is a possible or likely prospect is a subject that is likely to be with us far into the new century.

Over the years the Bologna–Claremont conferences have hotly debated such issues as fixed versus floating exchange rates, the gold standard, management (or mismanagement) of international crises in Mexico, Asia and Russia, economic development of the poorest countries, US economic leadership, the rise of Europe as a unified economic power, the rise of China, the role and functioning of the International Monetary Fund, the international debt crisis and sundry other topics. These analyses brought out sharp areas of disagreement as well as considerable consensus, reflecting the state of dissent in the economics profession at large. The proceedings of the conference reported here follow the same format that permits issues to be dissected, debated, analysed and re-analysed until, often, a consensus is reached. Even if a consensus is not reached, there is enough analysis so that the reader can choose sides or draw his or her own conclusions!

As time passes, a toll has been taken on many of our participants. The earliest conferences included famous economists like Lord Robbins, Robert Triffin, Edward Bernstein, James Meade, Jacques Rueff, Lord Kaldor and Marcus Fleming, all of whom have passed away. A particularly great loss was Randall Hinshaw who was offered and willingly accepted the difficult task of editing the conference series, a job he fulfilled with a dedication, sensitivity, skill and love that has, we think, been unrivalled in the history of economic conferences.

This conference may well be the last in the series, and it is fitting that its theme allowed us to look at the prospects for the evolution of monetary institutions for the new century. The dialog shows, however, that the ultimate form monetary arrangements will take in the twenty-first century is anything but a settled issue. The set of possibilities ranges from a single world currency, to a world with three currency blocks, to a large number of currencies pegged to two or three major currencies, to a large number of floating currencies. The benefits and costs of the alternatives are discussed at some length.

Management of the interdependence implied by large current account imbalances will pose new challenges for international monetary cooperation in the future. It is our hope that the dialog in this book will contribute to a better understanding of international monetary issues and stimulate much-needed new thinking on the subject.

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