GLOBAL FISCAL CONSOLIDATION, GLOBAL REBALANCING, THE G20'S MUTUAL ASSESSMENT PROCESS, AND REFORM OF THE INTERNATIONAL MONETARY SYSTEM [*]

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1 Introduction

The world has been through a financial crisis, the effects of which were catastrophic. Financial markets sized up, globally. This subsequently caused the most rapid downturn in global economic activity since the Great Depression.

In response, there was an unprecedented show of macroeconomic cooperation, and a worldwide coordination of fiscal and monetary policies. As a result, an all-out collapse was avoided. But this same process of cooperation will now be needed to sustain the recovery from crisis, and to address the global savings-investment imbalances which continue to pose a threat to global stability.

This paper first describes the risks to recovery and adjustment that the world now faces. I describe the macroeconomic disequilibrium now present in Europe, and I also describe the different kinds of risks coming from East Asia, and from world-wide financial difficulties. In the face of these risks I question whether the world is yet ready to absorb the process of fiscal consolidation which is now underway, world-wide.

The paper goes on to examine the reforms of global macroeconomic management which are now underway as a result of the Mutual Adjustment Process (MAP) of the G20. I consider the specific question of whether these changes might help the world guard against a too-rapid global fiscal consolidation. And more generally, I discuss whether these changes might lay the basis for a more cooperative way in which to manage macroeconomic interactions in the world economy. [1]

[1] The macroeconomic analysis presented in this paper is set out in more in detail in Adam and Vines (2009). In thinking about the macroeconomics of the crisis I have been greatly helped by Blanchard, *et.al* (2010), Bean (2009), and Obstfeld and Rogoff (2009). For a helpful narrative guide to the crisis, see Garnaut and Llewellyn-Smith (2009). Krugman (2009) and Caballero (2010) are thought-provoking..

This draft was written before the G20 Meeting in Seoul on 13 and 14 November. That meeting will have an implication for the matters discussed here.

2 The Global Policy Problem – Three Objectives not Two

2.1 The Advanced World

As is well known, *two* things are necessary for global adjustment.

- There must be a change in the *relative* levels of absorption, when comparing deficit countries and surplus countries.
- To make this possible, there must be changes in the *relative* prices of the goods coming from deficit and surplus countries.

But the world also needs to achieve a *third* objective

- a satisfactory *absolute level* of global growth

Much global policy discussion at present focuses on the first two of these objectives, without recognizing that the actions directed towards achieving them might put the third objective at risk.

At the London summit in April 2009 the world's leaders promised not to repeat the policy mistakes of the 1930s. The global response to the Financial Crisis thus involved an unprecedented display of global monetary cooperation – in the form of monetary easing. There was also an unprecedented display of global fiscal cooperation – in the form of fiscal stimulus programmes, and an agreement to allow the automatic stabilisers to operate as activity fell. In addition, attention was given to ensuring the solvency of the global financial system. Furthermore, fiscal authorities embarked, world-wide, on a range of schemes to recapitalise banking systems. It is widely agreed that these policy actions prevented the crisis from turning into another Great Depression.

As a result of these policies the public sector was obliged to go into deficit – by unprecedented amounts – in most countries. The consequence was very large increases in public debt. But while fiscal expansion has been effective at aiding the initial stages of global recovery, fiscal authorities cannot forever spend beyond their means.

Financial markets, and policymakers, are now focused on this question, and are concentrating attention on reducing public deficits and debt. They have settled on a view that sustained global recovery requires fiscal consolidation in the deficit countries. These are mainly Anglo-Saxon, advanced, economies (especially the US and the UK) but they also include the GIPS (Greece, Ireland, Portugal and Spain) in Europe. As a result, temporary stimulus packages are unwinding, and fiscal consolidation is setting in. Nevertheless unemployment in most advanced countries remains disastrously high. To solve this problem requires a sustained recovery, and continuing fiscal stimulus might continue to be necessary for this. The question now is this: how quickly should the fiscal deficit be closed in these deficit countries, and elsewhere, where fiscal consolidation is also taking place (e.g. in France and Germany). Will these attempts at fiscal consolidation, globally, put growth at risk, as has happened in particular countries in the past - in the US 1938 at the end of the Great Depression, and in Japan in the 1990s? Paul Krugman set out a clear version of this worry as it relates to the US in the *New York Times* 2 on 5 September. See Krugman (2010). This worry has been echoed by Nouriel Roubini. (See www.roubini.com)

Nevertheless mainstream projections of the recovery – *e.g.* by the National Institute of Economic and Social Research in London - are for global growth rate in 2010 of 4.8% , which is rather far from a in 2010 double-dip recession. This growth is clearly being fuelled by East Asia, with China predicted to grow growth at 10.6 percent p.a. Growth in the US is predicted to be at the much lower rate of 3.1 percent and that in the European area is predicted to be even lower, at an annual rate of only 1.8 percent. Nevertheless these numbers are still securely positive.

How do these double-dip worries, and the projection of a significant global growth rate, stack up against each other?

It is true that world output regained pre-crisis levels in 2009 Q4. But in the US this level was only reached in 2010Q2. In the UK and Germany output is not predicted by the UK's National Institute to reach this level until 2012. In Japan and Italy it not predicted and that this will happen until 2013. Thus the level of output will remain very significantly below its previous trend.

The worry is that in the US – and elsewhere – the demand for labour will remain way below trend. This means that, even if there is not actually a double-dip recession, unemployment will remain exceptionally high, for a very long period. This is now a massive social issue globally. This issue was, for example, discussed in the interview with Olivier Blanchard on the IMF's projections, an interview which took place on September 9. (See IMF, 2010). The recent election results in the US demonstrate that it is becoming a political issue as well. We can re-express Krugman's worries for the US as a concern that the level of output will not be anywhere near high enough to bring down unemployment, and enable a return towards anything close to full employment, for many years to come. This worry applies in many other places, not only to the US. Furthermore, there are risks posed to even the modest rate of recovery which would lead to this outcome.

Europe

The policy problem within Europe is a microcosm of that faced by the world. In Europe as in the wider world, three objectives (not two) need to be pursued.

Two things are necessary for adjustment within Europe.

- There must be a change in the *relative* levels of absorption when comparing the deficit countries and the surplus countries: *i.e.* there must be cuts of absorption in Greece, Ireland, Portugal and Spain - the GIPS coupled with expansion of absorption

in Germany.

- There need to be changes in the *relative* prices of goods coming from the deficit countries and the surplus countries: there needs to be below-average inflation in Greece, and elsewhere in the GIPS, for a long time, coupled with above-average inflation in Germany.

But Europe also needs to achieve a third objective.

- There needs to be a satisfactory *absolute level* of European growth

Most European policy discussion at present focuses on the first two of these objectives, without recognizing that actions directed towards achieving them might put the third at risk. Not only is adjustment of absorption in the GIPS extremely difficult. It appears likely that Germany will resist the second, 'coupled-with', part of the absorption-adjustment process described above. And the adjustment of relative prices within EMU - a common monetary system - is particularly difficult. Not only will deflation be difficult in the GIPS, but above-average inflation will – it seems likely - be resisted within Germany.

The issues are discussed in detail in Vines (2010). The question of relevance to the present paper is this. Will Europe will be able to deal these macroeconomic disequilibria? And if it does not - the world will have the resilience to deal with the resulting difficulties in Europe?

2.2 Emerging Market Economies

The picture is complicated by the fact that emerging market growth is very rapid, particularly in East Asia, with China predicted to grow by 10.6 percent this year. So slow growth is not a feature of the outlook for the entire world. Nevertheless, there are key questions concerning the extent to which rapid East Asian growth continues to rely on undervalued real exchange rates and on a growth in net exports. Thus, in the emerging market countries too there are also three objectives.

Two things are necessary for adjustment within East Asia.

- There must be a continuation of rapid domestic demand growth, so that *relative* levels of absorption can adjust as compared with the deficit countries
- There needs to be changes in the *relative* prices of goods coming from these countries, either through currency appreciation or through domestic inflation.

But East Asia also needs to achieve a third objective

- The level of absorption must grow fast enough to ensure that East Asia makes a satisfactory contribution , so that there is a sufficient *absolute* level of global growth.

At present, most discussion of the East Asian role in the world economy focuses on the first two of these objectives, without recognising that the size of the actions which need to be directed towards achieving them might depend on the role which East Asia is to play in

achieving the third.

2.3 The Plan of this Paper

In Section 3 I will describe three kinds of risks to global growth. In Section 4 I argue that fiscal consolidation compounds these risks – both at the European level and at the global level - and that Krugman's '1938 problem' is a real one, for the world as a whole. Sections 5 and 6 ask what the G20 and the IMF might be able to do about this, and consider the implications of this for the future of the international monetary system. Section 7 concludes.

3 The Global 'Adding-up' Problem

Within the OECD

The risks to global growth coming from the US are discussed in Altshuler and Bosworth (2010), and I will not repeat them here. I have described the risks coming from Europe in Vines (2010), and will not discuss theme here, either.

In most OECD countries, the private sector continues to repair balance sheets and, as a result, private-sector demand in 'short supply'. This is true for US, Japan and for some of Europe (although not for Germany). In Germany the low level of private sector demand arises for other reasons. In almost all OECD countries, the financial sector is continuing to act in a way which restrains expenditure by the private-sector: it is continuing to de-leverage voluntarily, which means making less loans, and it is also attempting to increase returns, which means a ensuring larger mark-up on whatever loans are made. As noted above, there are large balance-sheet risks to German and French banks, coming from problems in the PIGS. Furthermore, the regulatory requirements which are being rolled out in the form of Basel III, will lead to further de leveraging.

In Vines (2010) I describe how the macroeconomic imbalance within Europe is leading Europe to pursue export led growth. The difficulties mentioned here to do with finance, suggest that a risk-constrained financial sector is likely to significantly hold back the growth of domestic demand in the US. This means that the US has a similar interest to that of Europe in seeing demand recovery through a growth in the demand for its exports. That these interests are conflicting is apparent in the run-up to the G20 summit in Seoul.

Emerging market risks in East Asia, particularly in China

Ever since the Asian financial crisis in 1997-98, East Asia has relied heavily on export-led growth. Some optimism has been expressed about East Asian rebalancing, particularly in relation to China. Lau (2010) contains an argument suggesting that the turnaround in the current account surplus which happened in 2008-9, as global world trade collapsed, might be the harbinger of a longer run structural change. However the recent surge on the Chinese current account surplus suggests that this view might be overoptimistic.

Yu Yongding (2009) suggests a structural explanation of the Chinese imbalance. He notes that, at present savings in China are high, and domestic demand low, partly because of the high level of profits, both in the old state enterprises, and in the rapidly growing private

sector. These profits are not being distributed to the household sector, in a way which could stimulate a the required increase in consumption, but are instead being used to fund investment. In addition, he notes, a large fraction of the Chinese fiscal stimulus has also been used to finance large increases in public infrastructure investment, rather than to finance increases in consumption. Yu Yongding argues that this adjustment process in China is not sustainable. In due course, he argues, the extra investment will create extra capacity to produce output. If that capacity is to be fully utilised, then demand must grow further. If exports are to remain curtailed, and private savings remain high in this way, then the only way to increase demand might be to increase in investment, yet further. Yu is worried that this process may create an unstable upwards spiral, which would inevitably have to collapse downwards. There is – of course - a long-run solution to Yu's problem, in the form of a more rapid increase in wages. That would tend to encourage all methods of production to become more capital intensive, helping the extra savings to be absorbed, without requiring an ever-growing increase in the proportion of national income devoted to investment.[2] It would also tend to encourage consumption. But there is a real worry as to how quickly this adjustment in factor prices, and in production technology, will actually happen in China. The longer it takes, the longer Chinese policymakers will to continue to seek an outlet for their growing production through exports - pushing the world back towards the unsustainable outcome which contributed to the global imbalances. It appears that for domestic political reasons China may not be in a position to ensure the rapid recovery in consumption, and the demand-driven appreciation of the renminbi that this would entail. [3]

[2] This increase in wages, as capital grows faster than labour, is exactly what Solow (1956) supposed would happen in the Harrod-Domar growth model, if the 'warranted' growth rate was faster than the 'natural' growth rate.

[3] It is important to note that the required appreciation of the Chinese exchange rate also will be difficult to bring about. Estimates widely suggest that the Chinese currency is 30 or 40 percent undervalued..(See Obstfeld and Rogoff, 2009) This cannot be corrected, in a large immediate movement, without bankrupting firms geared towards producing for export. What is required is a gradual appreciation of the real exchange rate, at a rate of 4 or 5 percent per annum for say 10 years, over which time the current overvaluation of the exchange rate would be removed after allowing for continued increases in Chinese competitiveness, as compared with that in the US and other advanced countries. But such a gradual appreciation offers opportunities for speculative benefit, creating the possibility of large capital inflow in search of capital gains. These could bring the appreciation forward, creating the possibility of a 'reverse' currency crisis in which the renminbi appreciated greatly. Any attempt to moderate such capital inflow by setting lower interest rates within China

Yiping Huang and Bijan Wang (2010) present a complementary argument, focusing on costs, rather than on demand. They argue that a .key determining factor of China's imbalances is the repressed costs and prices of a number of factors of production, not just labour. They identify heavily distorted markets for all of labour, capital, land, resources and the environment. They note that the these repressed factor prices are, in effect, implicit subsidies for producers, investors and exporters. Such subsidies boost growth but, at the same time, lift investment and exports. They note that previous policy efforts to resolve imbalances have focused mainly on administrative measures, which – they argue – are not, and have not been, sustainable. They suggest that , a more fundamental solution to the imbalance problem will require more market-oriented reforms of the markets for factors of production, with the liberalisation of prices for all of labour, capital, land and resources.

These two explanations are complimentary, because a sustainable rebalancing will require *both* an increase in domestic consumption *and* an increase in domestic costs relative to those abroad. Both these arguments suggest that any rebalancing will be slow, however much it is kin the interests of policymakers to move in this direction. Blanchard and Milesi-Ferretti (2010) produce some simulations of such gradual adjustment, using the IMF's global economic model. They suggest that adjustment will be so sluggish that suggest Chinese net exports will continue to subtract nearly 1% of world GDP from the level of demand facing other countries.

Thus in East Asia too – particularly in China - there appears to be circumstances which are likely to both hold back the growth of domestic demand and dampen the adjustment of relative prices. This means that East Asia too has an interest – like that of Europe and the US

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would be vulnerable to the possibility that this would stimulate a too great growth in domestic demand, in the form of investment. Making a successful move in the required direction of currency appreciation seems to necessitate sufficient restrictions on capital movements so as to prevent the capital inflow from destabilising the process. It is possible that liberalising the financial system within China, in such a way as to encourage an increase in holdings of foreign financial assets by Chinese residents, might create a counterbalancing capital outflow which could offset any capital inflow. Movements of the currencies of other Asian countries will become much easier if the Chinese currency appreciates.

- in seeing demand recovery happen through a growth in the demand for its exports. [4]

In sum we can say that there is a significant risk of a global 'adding up problem', with all three regions – Europe, the US and East Asia – seeking export led growth, in a way which does not add up.

4 What Next – Global Fiscal Consolidation?

A fine balancing act

In the short run, as has been argued, the public sector has needed to supply enough assets to be held by the household sector as it increases its saving, and to be held by the financial sector as it de-leverages out of its holdings of risky assets. By contrast, in the medium run this fiscal position must be contained.

In the long run there is a risk that this fiscal correction does not happen and that a sustained global recovery might be jeopardised by continuing fiscal laxity – by a fiscal crisis, or, over a longer period, by sustained underlying fiscal difficulties. Many economists are now wondering whether there is adequate institutional defence of sound longer term fiscal policymaking in the US and elsewhere. Long term fiscal plans need to ensure that there is fiscal solvency. To ensure such longer term solvency, and yet create sufficient short-term flexibility, requires questions of fiscal policy design pof a holly new kind, which the world is only just beginning to grapple with.

[4] It is worth noting that the collapse in world trade at the time of the global financial crisis was extraordinary, and that, in the past year there has been a spectacular recovery. However, up until now, this recovery has been built, to a considerable extent upon a significant rebuilding of inventories. Continued rapid growth in world trade will, from now on, need to depend on a rapid growth in demand for imports coming from overall growth in domestic demand in significant countries. A recovery in trade cannot be relied on, in itself, to stimulate the global recovery.

Timing is crucial. The question of concern here is whether fiscal policymakers are coming under pressure from markets to cut the deficit too fast. If that is true, it is critical that fiscal institutions are made sufficiently robust to confront this pressure.

The Sizes of the Planned Cuts

The planned fiscal reductions in Europe *are large.* In the UK the plan is for a reduction in demand of 1.6 percent a year, over five years, i.e. a total of 8 percent of GDP. In France and Italy the planned consolidations are four or five percent over five years. In Germany the numbers are much smaller. But very large cuts are planned in Portugal, Italy, Greece or Spain.

In Japan a large consolidation is planned. In the US, the stimulus package is being withdrawn - this is what Krugman was complaining about. But – conversely – in the US there is no long-run consolidation package yet to be on the table. The US position is perhaps as bad as anywhere, in that there May be too rapid removal of the stimulus in the short-run, but no coherent fiscal-stabilisation plan for the long run.

To assess the effects of the fiscal consolidations that are underway requires an understanding of the size of the relevant multipliers. If the fiscal cut is permanent then debt falls, which will stimulate private sector expenditure and reduce the size of the negative multiplier. Even so, results quoted in the *National Institute Review,* for July 2010, suggest that the number is likely to be close to unity or possibly even larger.

It appears that results reported from e.g. the IMF's GIMF model may underplay the negative effects of the consolidation for two reasons.
(i) Estimates will be smaller the more forward looking the private sector is assumed to be and so the more the private sector looks forward the resulting future tax cuts
(ii) Estimates may include effects of interest rate cuts which follow fiscal consolidation. But such cuts will not be possible for some time yet. The effects of these cuts thus also depends

on how forward-looking the private sector it is.
Crucially, many estimates assume that currencies depreciate in countries which consolidate, so as to crowd in demand. But this cannot happen in all of the US, Europe and Japan at the same time.

This brief review suggests that there is a risk that fiscal consolidation will add to the risk of the global adding up problem identified above. We now discuss how these risks might be managed globally.

5 Fiscal Consolidation, Global Adjustment and the Global Adding Up Problem

We have seen that we need global rebalancing, which requires changes in relative absorption between deficit and surplus countries, and changes in relative prices. We also need satisfactory global growth. We have reviewed the prospects of this, and have seen that there are significant risks. Fiscal consolidation adds to these risks.

Analytically, the reason is that fiscal consolidation, on its own, does not cause a change in the *relative* levels of absorption. Instead, it causes a fall in the *absolute* level of absorption. To ensure a satisfactory global rate of growth requires that other demand grows fast enough, at the world level, to compensate for the effects of the fiscal consolidation. Otherwise the fiscal consolidation might create a global adding up problem, or magnify one which already exists.

5.1 A Game-Theoretic Restatement of the Global Adding Up Problem

The world faces a choice: either there is enough private sector growth to compensate for the fiscal tightening; or the fiscal tightening can lead to an outcome which does not rebalance the world but instead leads to stagnation. The choice will be ameliorated – in the short run - if one global authority – the US Federal Reserve – keeps interest rates low enough to help keep global spending growing But such a re-run of the 'Greenspan put' might push us towards another low-interest-rate bubble for the world. And a continuation of low interest rates might

still not be enough to achieve this.

The choice will be ameliorated – in the short run - if one government in the world – that of the US - continues to borrow enough to sustain global demand. Such an 'Obama put' would store up adjustment problems for the US in the future. As we noted at the beginning of this paper, Krugman sees this as unlikely. In this case the global growth trajectory would again be sustained by an outcome in which there are global imbalances. But such a trajectory risks – after, say, another five years - a significant further fall of the dollar. [5]

This is a Prisoner's Dilemma in which there are three possible outcomes.

(i) A Cooperative solution in which there is

- sufficient increase spending in surplus countries
- sufficient cut spending in deficit countries
- adjustment of relative prices to bring about expenditure switching

This solution would enable the world to meet all three of the policy objectives identified at the beginning of this paper.

(ii) A non-cooperative outcome is one in which:

- The risks reviewed in the earlier sections of this paper exert a strong negative influence
- fiscal retrenchment takes place in deficit countries
- there is an insufficient increase spending in surplus countries - in Germany, China, Japan and elsewhere - although for different reasons in each case – to make up for the fiscal contraction.

This is the case in which the global adding up problem is manifest. In these circumstances we can expect beggar-thy-neighbour currency depreciations in deficit countries, as each attempts

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[5] This dollar fall might have a significant overshoot – because the carry trade is so highly leveraged. I do pursue this issue here.

to go for export-led growth by means of currency depreciation. At present the UK has pursued this strategy – acting as a single small open economy. We can expect significant conflict if two major regions of the world – both Europe and the US – pursue this option at the same time.

(iii) A Stackelberg 'solution' is one in which:

- The risks reviewed in the earlier sections of the paper exert a strong negative influence, and there is insufficient increase spending in surplus countries
- there is fiscal retrenchment in deficit countries, except for the US
- the US keeps up its spending – by fiscal and by monetary means – acting, yet again, as a 'spender of last resort'

The US, acting in this way plays the role of a Stackelberg follower, attempting to recreate the 'great moderation', all over again.

Neither the second outcome nor the third outcome is good.

The *World Economic Outlook* of the IMF warned in June 2010 against outcome (ii). But it did not reveal whether, if that outcome was avoided, this would be because the outcome is more like (i) – the cooperative outcome - or like (iii) – the Stackelberg outcome. The simulations in Blanchard and Milesi Ferretti (2010) suggest that the outcome is more likely to be like outcome (iii).

Notice that this Stackelberg outcome would put enormous pressure on international cooperation about financial reform. One country – the US - running persistent current account imbalances, all over again, and the continuance of low interest world rates, would require a much improved system of global financial regulation. Such regulation would need to be strong enough to prevent a new global financial bubble from developing. That would require a considerable degree of international cooperation not only about macroeconomic policies, but also about financial policies. It is far from certain that the financial reforms currently contemplated will be robust enough to bear such a burden.

6 The Role of the G20 and the IMF

How might the G20 and IMF help to ensure a good global macroeconomic outcome?

Neither the G20 nor the IMF of course, actually has any policy instruments at its disposal of the kind which might ensure a cooperative outcome. It was this lack of any policy instruments which ensured that the IMF's previous system of multilateral surveillance – its 'multilateral surveillance procedure' - or MSP – was such an abject failure. The MSP has been replaced by a new process, the 'G20 Mutual Adjustment Process', or G20MAP. This new process is still very much under construction.

In the G20MAP countries have been given the task of implementing policies which move the world towards the cooperative outcome. At the Toronto meeting of the G20 it was made clear that not all countries can pursue export-led growth, because of the global shorting of demand, and global adding up problem which would result from this. Countries were given the task of working with the IMF to ensure that policies were proposed which would not point in this direction. Officials at the IMF have – since Toronto – been required to integrate these policies into alternative global scenarios, to determine whether the policies proposed are indeed ones in which

- Adjustment happens – i.e. policies in which China adjusts, the US adjusts, and Europe undertakes the necessary macroeconomic reforms disgust earlier in the paper – an outcome of the kind (i) above
- Adjustment does not happen and there is an inadequate level of global growth, even if there is not a worldwide double-dip recession – an outcome of the kind (ii) above, or
- Adjustment does not happen, but there is an adequate level of global growth, because there is enough spending in the deficit countries - an outcome of kind (iii) above.

This process of assessment is happening, as I write the paper. The IMF is, at present, making a judgement on these policies, and discussion of the outcomes is taking place, in the run-up to

the G20 meeting at Seoul in November. Country leaders have collectively given each other the task have of agreeing to policies which will bring about the adjustment outcome – an outcome of the kind (i) above, rather than a low growth outcome or a non-adjustment outcome. This process will – it is hoped – lock global leaders, officials in various countries, officials at the IMF, and officials at other international organisations, into a process to which they are committed to an outcome with adjustment - unlike the IMF's previous MSP which over the period from 2005 to 2007 did not succeed in doing this. The earlier failure of the MSP suggests that one should not underestimate the difficulties involved.

One thing has already changed, since that unsatisfactory experience. In contrast to the MSP, the MAP is a process which reports directly to global leaders, rather than being managed within the IMF, and reporting to the IMF's Executive Board. It is well known in the MSP, the Fund's Executive Board effectively blocked any significant discussion of adjustment outcomes, under pressure from countries most likely to be affected. It may be easier to reach an agreement on a adjustment process which reports directly to leaders of the G20, where the leaders themselves can be engaged in the process of hammering out a satisfactory outcome.

It will be interesting to see what happens at the Seoul meeting next month. In interpreting the outcome, it should be remembered that this is not a one-off exercise. If well handled, it might be the beginning of an ongoing process. At present it appears that there may at Seoul, uneasy agreement between those who want to consolidate and those who are worried about consolidation being too fast. But as circumstances develop during 2011, pressures might develop for a new set of policies to be adopted. Country officials, and IMF officials, might together work towards a new agreement to be reached next September, possibly coinciding with the Annual Meetings of the IMF.

If all this works, the process will begin to institutionalise, globally, a shared responsibility for managing the global macroeconomy. That will be a remarkable achievement in international institutional design. My hope is that what is happening will lock a community of global officials – both in the separate nations and in the IMF – and a community of global leaders,

into not just a one-off outcome, but an ongoing international process of collectively managing the world economy. The aim might well be to create a longer-term time-frame, in which the longer-term advantages of cooperating became more apparent to all involved.

At present, the G20MAP Process is being carried out in confidence. This might make it difficult, with 20 countries involved, to openly discuss the nature of the compromises involved in reaching a satisfactory global outcome, and the nature of the sacrifices which each country might be required to make in order to achieve a globally co-operative outcome. It is possible some of the lessons learned in the construction of inflation targeting regimes, managed by national central banks, might come to be useful in the construction of the G20MAP Regime. In particular, lessons about the usefulness of transparency in the operation of the inflation targeting process might be helpful. One way of ensuring a more transparent G20MAP Process might be to invite comment from a body of internationally respected economists, from a number of countries. These economists might be invited to comment, both on the policies proposed by the countries of the G20, and on the global scenarios which would result if those policies were adopted. Such a group of economists might be able to offer a more varied range of policies than those proposed officially. The availability of such a range of alternatives might assist G20 leaders in their deliberations.

This process of seeking such external comment could be carefully managed, in a way which ensured that it made a constructively critical, rather than damagingly critical, contribution to the overall process. In particular one might ensure that it was not seen as a technical criticism of the G20MAP work carried by the IMF. Instead it could be seen as a contribution from a group of outsiders, creating a vehicle which could be used to prompt politicians – and their officials - to ask questions in the process of reaching agreement.

7 Conclusion

In 1944, when Bretton Woods was established, Keynes saw the need for global support of good policies in individual countries, and the need for a global coordination of polices – to

guard against the risk of what he described as the 'scarce currency' problem. (Skidelsky, 2000, Vines, 2003.) Keynes saw that risk as the reason why a *system* was required which constrained national policies. This was a rules-based system, in which there was global surveillance of national policies. Now – in the face of a similar global problem - we need something similar [6]

There will of course be different details. But, as in the Bretton Woods system: there will need to be a multilateral regime, in which there is a set of rules shared by countries, which countries agree to follow. There will also need to be allowance for countries to act with discretion, where necessary, and not follow strictly prescribed rules. There will also need to be a formal process of surveillance, carried out within the IMF - a multilateral institution - which ensures that the rules are followed, and/or ensured that, when they are not followed, this is for cogent, and agreed, reasons.

This is a demanding agenda. But such an agenda appears to be necessary if policy-makers are to guard against a re-run of what has happened in the past three years.

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