

REFLECTIONS ON THE FUTURE OF COOPERATION BETWEEN CENTRAL BANKS

In a financially globalized world but where economic policies are independently decided by individual nations, what is the scope for cooperation between Central Banks?

Such cooperation cannot resolve by itself the problem of a worldwide optimal «policy mix ». No more than in the past. Indeed, governments remain responsible for their economic, fiscal and structural policies. Each Central Bank has thus to “navigate” in order to achieve its objectives as regards price stability. By definition, this navigation remains separate and difficult to coordinate.

But financial globalization makes cooperation between Central Banks and regulators all the more important. This cooperation has achieved well known results. I shall mention three examples :

1. The banking regulation concerning capital adequacy ratios. We know that the international agreement reached in 1987 (the “Cooke ratio”) has profoundly transformed the way banks operate (until then, they were practically free to act within the framework of their national standards) and powerfully contributed to the strengthening and the consistency of the international financial system. Basel II, crowning years of hard work and negotiations, is about to be implemented and opens a new chapter in the history of financial institutions. This enormous effort of rationalization, harmonization and modernization as regards risk evaluation and provisioning, is to the credit of what has been the real “melting pot” of Central Bank’s cooperation, namely the Basel Committee.

2. I would also like to mention, although the example is less recent, the cooperation between Central Banks as regards financial crises. The way the BIS -and thus the member Central Banks- contributed to the success of the restructuring programs of emerging countries sovereign debt -notably in Latin America during the 80s- is worth mentioning. And, also the role played by the Federal Reserve of New York at the time of the crisis of LTCM some years ago. I wish personally that Central Banks get more involved in the implementation of the "Principles", adopted in December 2004, both by issuers and private creditors as regards the prevention of debt crises and the restructuring of emerging countries sovereign debt.

3. In a more general way, Central Banks played -largely through their common approach fostered by their monthly meetings in Basle- an essential role in the formation of an anti-inflationary consensus since the beginning of the 80s. The fact that almost all Central Banks obtained their independence from governments during the last two decades and that they have adopted, in a form or another, inflation targets is a result of such common understanding.

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But what could be the scope of Central Banks cooperation for the future?

1. The field which I mentioned first -i.e. : cooperation between banking regulators will remain. Even if, over the last ten years or so, certain Central Banks have lost their power as regards bank supervision -responsibility which has been, in some cases, extended to all financial institutions and entrusted to enlarged and separate entities-, the cooperation between Central Bankers will remain nevertheless essential.

Indeed, with the elimination of financial borders, the development of new and always more complex products based on derivatives which are offered more and more widely to investors, the growing interconnexions between cross-border financial intermediaries, and the enormous and ever increasing electronic settlements through payment systems... are not factors that reduce systemic risks but, on the contrary, can increase them. The chain of transactions is long and involves a multitude of players. The break of a link of this chain can entail contagious reactions of which we had some examples in past.

And this is where comes up the problem of the lender of last resort. Always a touchy issue, but more difficult still in a world without borders. «Never speak about it publicly but always think of it», according to the old saying. This responsibility will remain one of the important tasks for Central Banks of tomorrow. In this field, Central Bank cooperation is more and more essential, although governments can also be -and will be- involved in insolvency crises.

In this respect, the May 18 2005 agreement on a Memorandum of Understanding between banking supervisors, central bankers and financial ministers of the European Union to deal with crisis situations is a reminder of the importance of this issue. The MOU is a way of enhancing practical arrangements concerning cooperation in cross-border crises situations at the EU level.

2. The world globalizes but it also tends to concentrate in more and more closely knit geographic zones. It is already the case of Europe. The creation of the euro in 1999 has changed the conditions of cooperation between Central Banks of the European Monetary Union. These Banks have established a "European System of Central Banks" and participate in the decision making and in the implementation of a single monetary policy. This system is about to include new members from Central Europe.

EMU Central Banks continue to ensure separately some responsibilities, in certain fields like -for some of them- bank supervision, like risk monitoring, like the functioning of the payment systems.... But they are henceforth actively bound in more and more narrow processes of cooperation.

The question is whether other monetary areas will emerge in the future and, if so, which will be the operating mode of cooperation of the concerned Central Banks, both between themselves and towards the rest of the world. The developments we are watching in East Asia concerning financial cooperation (CMI Swap arrangements between Central Banks, Asian Bond Initiatives...) could be the harbinger of further, deeper monetary integration.

3. Finally, is the vaster issue of the future of worldwide monetary cooperation.

This cooperation, through G10 and G7 has worked up to now within the limits imposed by the national interests pursued by each Member State. Rarely, Governments or Central Banks have agreed to change their own policies just to adhere to cooperative objectives (with the exception of the EMU). But policy recommendations were formulated and, in rare cases, followed. Were these recommendations always right? It is difficult to give a simple answer. But one can have doubts (i.e. the pressure exerted on Japan in the 80's to reflate it's monetary policy contributed, eventually, to the bubble and to the arduous and costly correction thereafter).

So what about macro-cooperation in a world where the current account deficits of the US have reached record levels, and are a threat to the stability of the system, where exchange regimes are, in many cases chosen "à la carte", where protectionist risks are always present and where the distribution of monetary assets held by Central banks changes dramatically ?¹

Will there be a real -and institutionalised- integration of China -a dominant player in the years to come- and other Asian countries whose currencies are de

¹ Thus, in 2000, 43 % of the total world reserves were held by the central Banks of industrial nations. Total reserves doubled in the last four years. Today, the so-called "emerging" countries hold almost 2/3 of the total (2,4 trillion \$ out of 3,7).

facto pegged to the US dollar, while their annual current surpluses represent some 300 billion dollars ? Will the IMF assume responsibility for firm currency surveillance and prevention of misalignments ?

Will the IMF play a central role in achieving that integration ? Will the present players be farsighted enough to open up to China and bring it in their inner multilateral circle ?

Those are some of the questions that will dominate the issue of cooperation between governments and monetary authorities in the years to come. Earlier they will be addressed in the framework of a credible IMF -seen and acting as the guardian of the system-, the more we should be able to avoid a “disintegration” of a multilateral cooperative system which, on the whole, has served the world well since the end of the second war. But, as Tommaso Padoa-Schioppa said at this conference, cooperation is far from intensifying at the speed of the interdependence of the world economy.