Referee Report on

„Global governance of global monetary relations: Rationale and feasibiliy“
by Jeffry A. Frieden

This paper makes the case for systematic inter-governmental cooperation on international monetary policy. Frieden's focus is on "the implications of a theoretically grounded analysis of the political economy of macroeconomic policy" (p. 4). He argues that misguided exchange rate policies can impose negative externalities on other countries and that, therefore, cooperative action would be justified since it can reduce transaction costs. In fact, an international institution could be charged with this task of global monetary governance. Frieden suggests that "perhaps, as in the sovereign debt realm, some collaborative effort by the IMF and the Bank of International Settlements (BIS) might be most appropriate" (p. 20). As a consequence, this institution should not only monitor and publicize substantial currency misalignments, but could even be allowed to impose trade sanctions and capital or exchange controls targeted explicitly at a particular country.

Frieden's powerful arguments appear to be so conclusive that an unsuspecting reader may wonder why there is no global governance of monetary relations yet. In the light of the subprime crisis, in particular, the issue addressed in Frieden's paper is highly relevant. The Public Choice and Political Economy schools, however, provide important arguments against this kind of global governance.

Taking a Public Choice perspective, one would doubt that rational self-interested politicians or central bankers would participate in costly collective action of the kind Frieden suggests. Political decision makers would only opt for global monetary governance when the gains of cooperation more than compensate for the costs of reducing their national policy responsibilities. The implementation issue is, however, not dealt with in this paper.

How does Frieden's proposal relate to the well-known commitment problem in monetary policy: why should the national politicians or central bankers adhere to a coordinated policy? Coordinated policies might be time inconsistent as policy makers always have an incentive to defect under domestic pressure once their national interest is negatively affected.

The Political Economy approach is to explain observed policies; optimality or social welfare maximization is not an issue. But in quite a few places, Frieden's argument appears to be normative, rather than positive. For example, he contends that "…the world would be better off with a more encompassing governance structure to manage international monetary relations" (p. 2).

Similarly, after discussing a number of cases, Frieden asks: "could these outcomes have been improved by international cooperation?" – which begs the question whose interests are affected by such an "improvement". His perspective resembles that of a benevolent social planner, and thus conflicts with the positive approach that deals with the feasibility issue emphasized in the title.

Frieden provides examples of politicians coordinating their monetary policies. But why did they not implement a global monetary governance system in the past? The Bretton Woods system, after all, was a failure. Frieden's paper would become more relevant if he explained why individuals would vote for some kind of global monetary governance at the present time. The subprime crisis could be used as the prime example.

Frieden (p. 2 f.) is unusually direct in attempting “to convince Horst Siebert that his long-standing interest in institutionalized international cooperation should be extended to the monetary realm”. Horst Siebert himself, however, does not seem convinced by Frieden’s proposal. In a recent paper he stated (without direct reference to Frieden) that “the IMF cannot play the role of the world economy’s chief regulator. For the same reason, it cannot be the world’s central bank; countries would not cede monetary authority to the IMF” (Siebert 2008: 28).

Adherents of the Public Choice and Political Economy schools will be skeptical about Frieden’s proposal on global monetary governance. In the wake of the subprime crisis, however, scholars need to face up to these open questions. Frieden’s recommendations will stimulate the academic debate and induce critical responses from various perspectives.

Reference

Siebert, Horst (2008). An International Rule System to Avoid Financial Instability. Kiel Working Papers No. 1461.

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