Legal Framework for Monetary Policy Coordination at the Global and Regional Levels

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Abstract. Subject of the research: historical, institutional and regulatory aspects of monetary policy coordination at the global and regional levels. The purpose of the research is to study the current aspects of international monetary policy coordination paying special attention to the prerequisites, legal and institutional foundations of such coordination. This study is predominantly based on scientific papers and documents issued by International Financial Regulators. The set of theoretical ideas generated on the basis of the analysis of the topical issues of international monetary policy coordination will enable to introduce the positive aspects of such coordination on the level of regional cooperation of Central banks within the framework of Eurasian integration associations, primarily the EAEU. The methodology of the research comprises historical, comparative, formal-legal and functional methods, systemic approach. The paper examines alternative (regional) financial support mechanisms (including bilateral currency swaps) implemented by Central banks. It is concluded that it is necessary to find ways of integration in the monetary sphere, bypassing the IMF, which is especially important in crisis periods of economic development. The conclusions given in the paper can form the ground for further studies of international monetary policy coordination in the context of globalization and regional economic integration.

Keywords: Bilateral currency swaps · Central banks · Group of Twenty · International monetary policy coordination · Monetary policy

1 Introduction

Among the main methods of cooperation between states in the monetary sphere, the coordination of monetary policy stands out, which can be effectively implemented both at the global and regional levels. In the first case, we are talking about the interaction of states within the framework of international organizations - the International Monetary Fund, the Bank for International Settlements, as well as informal platforms like the Group of Twenty. In the second case, on the coordination of monetary policy at the level of integration associations (for example, in the EAEU), as well as on interaction through the conclusion of bilateral agreements by central banks.

One of the main reasons for the increased attention of global financial regulators to the problems of international coordination in the monetary sphere is certain negative
phenomena of the crisis period, which affected, among other things, developing countries with market economies. Excess liquidity created by the FRS, ECB, Bank of England, Bank of Japan within the framework of the quantitative easing (QE) mechanism caused a number of currency problems in developing countries.

The problem of international coordination of monetary policy is receiving more and more attention in the economic and legal literature. Among the most significant should be noted the progressive work of Bruni, Serrate, and Villafranca “The quest for global monetary policy coordination” [4], full with proposals to optimize the existing mechanisms, the work of Bordo and Schenk on the history of monetary policy coordination [2], the works of outstanding experts of the Bank for International Settlements of Borio and Toniolo [3] and Taylor [11], as well as other authors [8, 10].

2 Methodology

To consider issues of international coordination of monetary policy, the historical method (in part of the history review of cooperation between central banks), the comparative method (to compare the role of the IMF (International Monetary Fund) and the BIS (Bank for international settlements) in a modern monetary legal system, the comparison of the role of the IMF and Central banks in crisis management mechanisms to maintain liquidity), formal-legal method (in the analysis of legal instruments of global financial regulators, a group of Twenty, IMF, BIS), functional method (in the analysis of coordination and crisis management functions of global financial regulators and central banks in the context of international monetary law), system approach (in terms of the analysis of the distinctive features of the modern monetary system) were applied.

3 Results

3.1 Coordination of Monetary Policy at the Global Level

International monetary coordination has exactly the same depth of historical retrospect as the history of the world monetary system. Bordo and Schenk traces the relationship between the degree of intensity and directions of coordination with the stages of development of the world monetary system and concludes that such coordination has not always been successful and necessary [2]. At the same time, terminologically, Bordo and Schenck distinguish cooperation and coordination. By «cooperation» they mean the exchange of information, discussion of typical problems, mutual lending and other operations between central banks in times of financial crisis. By «coordination», the authors refer to strategic measures officially agreed by the heads of central banks and finance ministers of different countries and aimed at achieving favorable results for the international system as a whole. Such actions may potentially conflict with the internal strategic goals of central banks.

Thus, successful communication between central banks took place during the Gold standard era (1880–1914) and during the so-called “Great moderation” (1985–2006);
less successful - during the gold standard period (1924–1936), during the operation of the Bretton Woods system (1944–1973) and in the early 1980s.

The authors believe that in monetary regimes that are rules-based, cooperation was most successful, and much less - in regimes that operate on the basis of discretion. In monetary regimes that are rules-based, cooperation was most successful, and much less - in regimes that operate on the basis of discretion. Monetary policy cooperation does not work when domestic and international strategic priorities are inconsistent, that is, when an international strategic rule (such as exchange rate stability) is in conflict with domestic goals of price stability or full employment.

Experts of the Bank for International Settlements (BIS) Borio and Toniolo [3] classify central bank cooperation in two ways. «Restrained» cooperation is an exchange of information between central banks, while «high-quality» cooperation is a joint action. Throughout the history of central banking, the first type of cooperation prevailed, especially after the establishment of the Bank for international settlements. The latter is mainly associated with large-scale financial turbulence.

A significant factor contributing to the intensification of cooperation between central banks on monetary policy issues was the global financial crisis of 2007–2009.

The G20 summits held in the period 2013–2019 highlight three aspects that were discussed there and included in the final declarations or communiques on the results of these summits:

- recognition of the negative effects of the QE policy and the subsequent “devaluation race”,
- calls to return to traditional monetary policy,
- promoting cooperation between central banks.

The G20 initiatives are supported by a dozen and a half standard-setting bodies, among which the BIS and the IMF are primarily involved in the monetary sphere. The BIS is a very important platform for cooperation between central banks today. It also provides interaction between monetary, microprudential and macroprudential policies.

The Bank for international settlements has three main communication platforms: the Global Economy Meeting (GEM), the Economic Advisory Committee, and the All Governors’ Meeting. In addition, the BIS have a Central Bank Governance Group and the Irving Fisher Committee, with a broader membership than GEM.

The BIS has long questioned the benefits of cooperation in the monetary sphere. However, he later pointed out that achieving a more effective result would require increased cooperation, including special joint actions, and perhaps even an agreement on the rules of the game that limit domestic politics. Today, the BIS proposes to go beyond the national mandates of central banks and consider the internationalization of financial regulation as an example for monetary policy.

Bruni and his colleagues, based on the reports of the BIS, believe that the heads of central banks should regularly and officially discuss and agree on certain strategic provisions of their monetary policy, and inform markets on their decisions. She believes that this discussion is not in contradiction to national mandates; moreover, at the international level, coordinated solutions are already the norm in micro- and macro-prudential regulations, which are increasingly linked to monetary policy principles [4].
As for the European Central Bank, it usually combines orthodox statements about the inevitability of internal orientation of monetary policy with the liberal recognition that global general shocks and international flows justify the search for some informal and implicit coordination of monetary policy [6].

Some authors provide evidence of the benefits international monetary policy coordination [7, 9, 11]. Using various econometric indicators, they find that GEM participants have a significantly higher correlation of monetary policy decisions due to their greater coordination.

Today’s monetary policy makers face a problem called “normalization”. For many years, international liquidity creation has relied on non-traditional instruments: this has been due to extremely low interest rates. The BIS (following the G20) believes that with the global recovery and the end of deflation fears, it is time to return to the traditional monetary issue and interest rate as a monetary instrument [1].

The term “normalization” describes a gradual exit from the extraordinary (unconventional) monetary policy that was adopted to combat the effects of the global crisis. Competitive monetary easing “narrow normalization path” is overcome within the framework of the so-called “narrow normalization path”. At the same time, new quantitative easing programs launched in order to overcome the negative economic consequences of the COVID-19 pandemic (for example, the ECB program called the “Pandemic emergency purchase program”, PEPP) call into question the timing of the transition to long-term normalization of monetary policy.

Bruni and colleagues point out that the national mandate of central banks should not be an insurmountable obstacle to reaching an agreement on coordinated normalization. To be in accordance with national mandates, “coordinated strategies” will be the «least common denominator» of national provisions on what should be done in the monetary sphere. Hence, it is obvious that the set of coordinated decisions will be smaller than the set of all measures taken by individual central banks, which will act within their autonomy [4].

Since none of the platforms of the BIS or the IMF seek explicit and formal coordination of monetary policy, this allows us to make proposals for moving towards such coordination. So, Bruni and his colleagues suggest creating a new platform at the Bank for international settlements – the “Global Monetary Policy Coordination Meetings” (GMPCM). The expert suggests that these meetings should be considered as a partial replacement (or as a component) of a more comprehensive initiative, the Mutual Assessment Process (MAP) [4].

Creating a legal framework for international monetary policy coordination nowadays has research prospects. In particular, we can mention a similar study conducted at the Max Planck Institute in Germany. The project is called “Law of international monetary policy coordination”. The author of the project Kanad Bagchi notes that in recent years, along with the IMF, several other institutions, both formal and informal, have begun to play an important role in promoting monetary policy coordination and mitigating international monetary conflicts; against this background, the main task of the project is to conceptualize the legal framework for monetary policy coordination by analyzing the institutions, formats and mechanisms through which such coordination is carried out on an international scale.
3.2 The Role of Central Banks in Creating the Crisis Management Mechanisms of Financial Support

The increased initiative of central banks in terms of international coordination is also evident from the objective increase in their status in times of crisis and the parallel decline in the role of the IMF and its anti-crisis mechanisms. The mechanism for states’ adherence to international obligations has become blurred and less strict, largely due to the increased international activity of central banks during the crisis and post-crisis periods. An example of such activity is the transnational *swap agreements* that have called into question the role of the IMF as an international lender of last resort (ILOLR).

The practice of swap agreements between central banks, which appeared in the 60s of the last century, was significantly activated during the global financial crisis of 2007–2009. At the same time, the researchers asked the question: why did many emerging market countries (EMEs) choose to resort to bilateral swap agreements rather than access the formalized multilateral and regional instruments of the IMF to overcome their liquidity problems?

As noted by Duran [5], this movement had two phases: the 2008 crisis management, which demonstrated a preference for special currency swaps, and the post-crisis consequences, which formalized these swaps into regional measures based on networks of bilateral currency swaps).

These are primarily swap agreements between the FRS (Federal Reserve System) and the central banks of Mexico, Brazil, Singapore, and South Korea, as well as between the Bank of Japan and the central banks of Indonesia, South Korea, and India. The role of the FRS in overcoming the liquidity problems of a number of countries was so great that the concept of “sovereign international lender of last resort” was proposed. Among the prerequisites for this choice of EME countries in the literature are the following:

1. If we consider alternatives, the accumulation of foreign reserves in the central bank is associated with increased fears of dependence on the international monetary environment. And as for the IMF’s programs, as noted by E. Helliner, a two-way swap is more accessible to countries than the IMF’s support programs due to its automaticity.
2. The international monetary system is becoming not only more fragmented, but also more diverse, aiming for multicurrency: swap agreements have been formalized in hard currencies (i.e. the US dollar), as well as local currencies such as the Chinese yuan and Korean won [5].
3. Currency swaps have a unique legal structure: currency liquidity, without any ex ante transfer to an international organization, is “in the hands” of national banks until the swap is activated.
4. The specific design of these new measures reflected an increased role for central banks in monetary transactions, rather than delegating this role to international organizations. This is especially true for the central bank in times of crisis, while in quiet times power reverts to the finance ministries [5].
The global role of central banks is changing the institutional nature of monetary cooperation even in the post-crisis period. So, in 2013, the FRS, the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank jointly announced the creation of a permanent network of bilateral currency swaps.

4 Discussion

Based on this, it should be noted that the institutional design of international cooperation in the monetary sphere leads the world to a more fragmented and multi-currency system. The paper examines the historical, institutional and regulatory aspects of interstate cooperation in the monetary sphere: international monetary policy coordination, regional financial support mechanisms. Particular attention is paid to the reduced role of the IMF in the international monetary order, as well as to the increased role of agreements between central banks in order to overcome liquidity problems.

The analysis of current issues of international monetary policy coordination allows us to form a set of theoretical ideas that can allow us to transfer the positive effects of such coordination to the level of regional interaction of financial and monetary regulators within the framework of integration associations in the Eurasian space, primarily the EEU. The practical significance of the obtained results is to improve the legal and institutional framework for integration interaction of the EAEU member states in the monetary sphere.

5 Conclusions

Based on the results of the study, the following conclusions can be drawn:

1. Due to the decline in the role of the IMF as an “international lender of last resort” and an international coordinating platform in the crisis and post-crisis period, alternative legal forms of interstate monetary cooperation (without the mediation of the IMF) have become more important: bilateral currency swaps, regional financial support systems, and coordination mechanisms based on the BIS (international monetary policy coordination).

2. The positions of modern global financial regulators agree in recognizing the importance of central bank cooperation on monetary policy issues at the global level. The policy of quantitative easing (which translates negative factors from developed to developing economies) is replaced by a paradigm of monetary policy normalization. This normalization should be carried out in conditions of international coordination on formal or informal platforms. Empirical studies prove the usefulness of this coordination for the economies of the countries involved in this process (primarily on the basis of the BIS), as well as for global financial stability in general. The legal doctrine justifies the need to develop legal forms of such coordination.
3. Being in the initial phase of the next global economic crisis (caused by the COVID-19 pandemic), it is important to pay increased attention to central banks as actors in international monetary relations, the specifics of their international legal status, the correlation and interaction of alternative anti-crisis legal mechanisms in the international monetary order with traditional intergovernmental legal mechanisms formed by the IMF.

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