Opening remarks

by Már Guðmundsson, Governor of the Central Bank of Iceland, at a conference organised by the Bank and the Reinventing Bretton Woods Committee on *The uncertain future of global economic integration,* Harpa Concert Hall and Conference Centre, Reykjavík, 14-15 September 2017.

I welcome all of you to this conference and the foreign participants to Iceland. The conference is organised by the Central Bank of Iceland and the Reinventing Bretton Woods Committee. The heading is broad and probably reflects in part the worries that some of us might currently have about the future of global economic integration.

The topic encompasses both real economic integration – that is, trade in goods and services and the flow of labour and equipment across borders – and financial integration – that is, cross-border capital flows and stocks and associated activities of banks and other entities.

The financial integration part will probably dominate the proceedings, not least because most of the speakers are current or former central bankers. I do not see that as a problem, as in my mind more work remains to be done in assessing the costs and benefits of global financial integration than regarding real side economic integration. After all, the post-war global economic order was initially based on the principles of free trade in goods, current account convertibility, and monetary stability through fixed but adjustable exchange rates vis-à-vis the US dollar. Open capital accounts were the exception, however. Real side economic integration was seen to be more important for economic progress than financial integration.

It worked well for a long while, and some call the period from 1950 to 1970 the golden years. Yet there were inherent flaws in this set-up that contributed to its demise in the early 1970s, not least the well-known Triffin dilemma regarding the conflict between the domestic economic objectives of the country providing the main reserve currency and the required international supply of that currency. Then capital accounts were opened up, with strong momentum in the 1980s and early 1990s. Capital controls were increasingly undermined by technology and financial innovation, and strong arguments were being made to the effect that open capital accounts would bring significant benefits. After all, ongoing real economic integration at a global level demanded at least some degree of global financial integration. As the BIS reminded us in its latest Annual Report – and Jaime Caruana might touch on in his keynote speech later in this session – trade and finance tend to go together. Freer capital movements in turn undermined pegged exchange rates and thus contributed to the spread of flexible exchange rate regimes and inflation targeting.

There can be little doubt that both real and financial global integration have brought enormous economic benefits. Still, it has been increasingly questioned of late. We partly understand why.

We know that there are significant gains from real integration but that there are winners and losers. The losers can be compensated in principle, but in practice this does not always happen. Inequality has increased within many countries and economic integration is blamed, although research shows that technological change plays a significantly bigger role.

At least in part, the case of financial integration is different. Finance is an integral part of economic progress, and there are significant benefits from global financial integration. But more is not always better when it comes to finance, as we learned the hard way during the latest financial crisis. Furthermore, large and volatile capital flows can undermine the financial stability of countries. It is not clear who the winners are in that case nor what the compensation mechanism would be. Spillover effects from monetary policy of global rate setting countries to small, open and financially integrated economies (SOFIEs) increase as global financial integration intensifies. In particular, if the global rate setter experiences an economic slack at a time when a SOFIE is booming, the SOFIE might find it difficult to pursue warranted macroeconomic policies without risks to financial stability and/or significant detrimental effects on export sectors. This could be the case if there are perceived limitations to the use of fiscal policy; for instance, if there is already a sizable headline surplus. In this situation, macroprudential and even capital flow management measures could help. In Iceland's case and some others, this raises the issue of compatibility with existing international and regional treaty obligations regarding free movement of capital. The jury is still out on these issues.

It is one thing to try to make global financial integration safer and to mitigate unwanted spillover effects – which might involve some retrenchment, as it did in this country and many others after the crisis – but it is another matter entirely to bring about a large-scale reversal of the global financial integration of recent decades. Most likely, such a reversal would seriously undermine real economic integration and the benefits associated with it.

We are going to discuss these issues and others that pertain to the current state and future prospects of global economic integration. After Jaime's keynote speech, we will have two sessions with substantive presentations and discussions on different aspects of the topic. This afternoon, we aim to take stock of recent trends in global and regional economic and financial integration, assess country responses to these trends, and discuss how the responses in turn affect the level of integration. This includes macroprudential and capital flow management measures. We will probably hear something about how the challenges have been addressed in this country.

Tomorrow we turn to the international monetary and financial system. Part of that discussion will aim at identifying potential reforms that would better allow individual countries and the global economy to reap the benefits of economic and financial integration and avoid the risks associated with it. We will then wrap up with a policy panel.

Looking at the programme, I am particularly pleased to note the high level of the speakers. I am even more pleased to see how many of them are old colleagues and friends. The speakers will all be properly introduced in their sessions. Let me just note that the relevant international organisations are represented at a high level. We have a General Manager of the Bank for International Settlements for the first time in Iceland. We have also a chairman of the Basel Committee for Banking Supervision for the first time in Iceland, as far as I know, although Stefan has of course been in Iceland several times with other hats. We have Deputy Managing Director of the IMF for a second time in Iceland. We have two current governors (not counting me) and two former governors. We have three former deputy governors from G20 countries and we have prominent academics. As you have probably realised there is some double counting in this, which just goes to show the quality of the speakers.

Before I make my final remarks, I would like to remind us all that this is a closed-door invitation-only event. There is no press here, and we are under modified Chatman House rules, which imply that you may use what you hear in your work and even speak about the event, but without attributing to or quoting individual speakers. We wanted to have it this way in order to facilitate frank and open discussion of a difficult topic that many of us are trying to get a handle on. The aim is to contribute in some small way to improved policy making at the global, regional, and country levels.

In closing, I would like to thank all of those that have worked hard to make this event possible, especially the staff in my own office. Last but not least, let me thank our co-organiser Marc Uzan, Executive Director of the Reinventing Bretton Woods Committee. This is the third event that he has been involved with in Iceland. He has organised roughly 100 seminars around the world and must be among the best connected individuals in this business. At the time of the 70th Anniversary of the Bretton Woods Conference he edited a large volume of short essays on the international monetary system that I among many others had the pleasure to contribute to. I have also spoken in several of his seminars. It is a great pleasure to work with him, and he has become a good friend. I have come to realise that what drives him is a passion to improve the international monetary system. It matters a lot, and for various reasons it matters more for small countries like Iceland than for big countries that can better fend for themselves in a non-multilateral and non-rule based world. That is why we are having this conference here. Marc, the floor is yours.