REMARKS AT THE ECB – ASIA CONFERENCE – Amsterdam – April 2011

It' a great honor to be here to day and substitute for Governor Noyer who has asked me to express his sincere regrets for not being able to make it to this session. It is also a great privilege to comment on Governor Prasarn's insightful presentation.

I certainly agree with the governor that the current state of the global dialogue on capital volatility and capital controls is not fully satisfactory. I see two reasons for this situation :

- first, there may be misperceptions in some circles as to the starting point. Most discussants are assuming that freedom of capital movements is the norm and controls should be the exception. That is certainly the objective in an integrated world economy. But it is not the situation to day. At the moment, members of the IMF are legally free to choose their capital account regimes. Attempts to give the IMF increased juridictions in this matter have met, in the past, and still meet with strong resistance. May be as the story says, we should not start from here, but that's where we are. Simply ignoring this reality will only lead to misunderstandings and impasses.

- fhe second reason is that the rationale for capital management measures has not been fully and extensively spelled out. Most often, those measures are seen as a second best in the panoply of macroeconomic tools. As a consequence, they often apppear as way to delay necessary adjustments, or, worse, as accessories to exchange rate management, not to speak of manipulation. Hence they are tainted with an enormous suspicion from the start. That, of course , leads to a very reluctant approach to discussing a framework. Capital flows management measures are presented, including by the IMF, as a last resort in a normative sequence of policy responses to external shocks. It is therefore somehow natural for the dialogue to be perceived by recipient countries as an attempt to circumvent or limit the freedom of action which they possess according to IMF articles.

Obviously, , the two issues, exchange rate and capital account regime cannot be fully dissociated. But the problem is broader. In a domestic setting it is well recognized that sound monetary policy is a necessary but not sufficient condition for financial stability. Additional tools are needed and all countries are actively working , to build efficient frameworks for macro prudential policies. The same, I think, holds true at the global level. We need additional tools to better manage the interaction of our monetary policies in its consequences financial stability, without compromising their independance and their efficiency.

there is a good case for having, at the global level, a more coordinated approach to financial stability. To quote the very appropriate formula by Professor Obstfeld, we should look at the world as a single financial system. Capital markets are global, and so, to some extent, should be the macroprudential measures taken to achieve greater stability. This, in my view, is the main rationale behind the work on " capital flows management measures". They should best be seen in a framework of global financial stability. It is commonly accepted that such measures do not impact the volume of flows, only their composition. But in a financial stability perspective, composition matters. Those measures should not be seen, or devised, therefore, as macroeconomic tools, substituting to others in the adjustment process. Rather, they can be part of a continuum of instruments deployed to implement macroprudential policies.

To achieve that objective, however, several conditions must be met.

First, there must be, in each country, full consistency, almost a continuum, between domestic macro prudential measures and those which affect non residents or cross borderflows. For instance, limiting a boom in foreign currency denominated domestic lending may imply both higher reserve requirements on foreign currency loans imposed on domestic banks (the "domestic" part) and limits on foreign currency borrowing from non-residents (the "external" part) . By the same token, limiting excessive stock market volatility can require a raise in margin requirements as well as a tax or a quota on inflows

Second, there also must be consistency between policies implemented in " source" and recipient countries as regards international capital movements. There would be little sense to introduce or accept regulatory imcentives to export capital in some countries while others are deploying measures to prevent capital inflows. I am not sure that a close examination of our prudential regimes would not show some inconsistencies in this regard. Regulators are aware of this type of spillovers, for instance, when they discuss the implementation of the countercyclical capital buffer under Basel 3.

And finally, there must be consistency between measures and policies taken in different recipient countries. Markets are increasingly discriminating between emerging economies, which cannot be considered as a single asset class anymore. However, there are still common " push" factors, coming either from macroeconomic policies or fluctuations in risk appetite. When faced with a common shock, there may be little sense, for each individual economy, to try and protect itself through specific, taylor made, policies. This only deflects the pressure on other recipient countries, and imcrease, rather than decrease the degree of overall volatility. The rapid increase in trade and financial globalisation has amplified such spill-over effects. As a result, policy actions that affect international capital flows cannot be assessed from the viewpoint of each individual economy only, but should also take the international dimension into consideration to avoid globally sub-optimal results.

Ensuring this triple consistency may be a matter of useful dialogue between all countries, advanced and emerging, source or recipient of capital flows. I agreee with Governor that this dialogue may have to be better oriented to produce constructive results. I think this is achievable a reasonable period of time. And, as you know, it is part of the French G20 Presidency agenda.

On the longer run, there may be a more ambitious agenda to tackle. Clearly all countries participating to the global financial system do not fully converge on how they see their financial systems and on the optimal organisation of financial intermediation. Those divergences and asymetries are normal , and should be expected, as they reflect national preferences and choices. Our challenge, for the future, is to ensure that those different financial systems interact harmoniously. My intuition - it is no more than that - is that those assymetries have the potential to create additional volatility, for instance by amplifying the normal effects of normally divergent monetary policies. They could also distort global capital flows by orienting investment towards those countries and assets whose markets are more developped and/ or more liquid. Avoiding those side effects may not need full harmonisation or comvergence in regulatory approaches. But some degree of compatibility may prove necessary. It will be a major task for the Central Banking and regulatory community to find the right balance through mutual dialogue, in particular in the FSB.