

# THE INTERNATIONAL MONETARY SYSTEM: DEVELOPMENTS AND PROSPECTS

*Jacob A. Frenkel and Morris Goldstein*

## Introduction

This paper addresses several fundamental issues raised by recent developments in the world economy and considers their implications for the design and functioning of the international monetary system. We do not make any proposals. Our purpose instead is to identify factors that merit attention in any serious examination of the system.

First, some background. Over the past several years, the international economic landscape in the industrial world has been dominated by the following key developments. To begin with, there have been unprecedented current account imbalances for the three largest economies. In 1987, the United States recorded a current account deficit of \$154 billion, while Japan and the Federal Republic of Germany registered surpluses of \$87 billion and \$45 billion, respectively (see Table 1). A primary objective of policy has been to reduce these external imbalances while still maintaining satisfactory growth of the world economy. The contribution that fiscal policy should make to reducing absorption relative to output in the United States, and to increasing it in surplus countries, has become an integral—and often a contentious—element in the policy dialogue. Suffice it to say that the adjustment of fiscal positions has proven to be a difficult process, with firm evidence of a narrowing of earlier divergencies apparent only within the last year or so (see Table 2).

Heavy official intervention in exchange markets (especially during 1987) and episodes of coordinated adjustments in interest rates—

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The authors are, respectively, Economic Counsellor and Director of Research, and Deputy Director of Research at the International Monetary Fund. The views expressed are the authors' alone and do not necessarily represent the view of the International Monetary Fund.