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Crisis-management skills will be needed at the Fed

Ben Bernanke, President George W. Bush's nominee to be the next Federal Reserve chairman, is an excellent choice – an exceptional economist, a past member of the Fed board, an independent thinker. But given his relative lack of real-world experience in financial markets, will he demonstrate the formidable global knowledge and international diplomatic skills that he will most definitely need?

Paul Volcker and Alan Greenspan, the last two occupants of the job, presided at a time of extraordinary expansion of global capital flows and the growth of a mind-boggling array of high-tech financial instruments that link national markets. Now, for example, there are nearly $2,000bn of foreign exchange transactions every day, double the level of just five years ago. The daily value of financial derivatives transactions has risen from nearly zero in 1990 to well over $1,000bn. Foreign investors control 40-50 per cent of the capitalisation of most European equity markets and the US borrows more than $2bn a day from abroad.

Mr Bernanke will operate in a period of even greater internationalisation of markets. In the past, US financial interdependence was mostly measured in terms of involvement with industrialised countries – but in the next decade, the most dramatic intertwining of America's financial relationships will be with countries such as China, India, Brazil and South Korea.

The growing power of these emerging markets will shift the location of where goods and many services are produced, leading to fundamental changes in trade and monetary flows. The entry of billions of new workers from these countries into the global economy will alter the calculus between global growth and inflation. These developments will have critical implications for US and global interest rates, as well as for the course of the dollar and other currencies.

The ageing populations in Europe, Japan and America will also materially affect patterns of global savings and investments and hence the flows of capital. In addition, the stretched supply chains that reach into every corner of the globe, in industries ranging from energy to electronics, have created new economic vulnerabilities that also are only now becoming clear.

The toughest crises that Mr Bernanke will face will have strong global dimensions. Mr Volcker had to contend with a collapse of the Mexican economy and the yen-dollar tensions, Mr Greenspan with the 1987 stock market meltdown, the Asian financial crisis of the late 1990s, the bursting of the internet/technology bubble of 2001 and the September 11 2001 terrorist attacks. Yet Mr Volcker had a long history in the US Treasury and the New York Federal Reserve, while Mr Greenspan had been an influential consultant to companies and financial institutions and a Wall Street insider. Mr Bernanke could well face a series of challenges – relating to terrorism, pandemics, another huge spike in oil prices or the disorderly unwinding of global economic imbalances – but he will have to acquire international crisis-management skills on the run.

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The next Fed chairman will also need to possess acute diplomatic skills at a time when leadership is in very short supply elsewhere – including in the multilateral system where the International Monetary Fund has lost its way and the Group of Eight leading industrialised countries is a pathetic reflection of what it should be.

To be sure, there is a long history of close co-ordination among key central banks that will help the next Fed chairman get his bearings. But it will be interesting to see whether, in the context of intensifying globalisation, the Fed will still need to pioneer some institutional innovations.

Given the build-up of reserves and economic power in Asia, plus the time-zone differences, for example, will the Fed need to establish an outpost in the region, above all for continuous human interaction with central banks and other investors there? By the time he steps down, which could be nearly two decades from now, will Mr Bernanke have invited his counterparts from China, Japan and the European Central Bank to sit in on selected Fed meetings to get real-time views and enhance their understanding of how the US sees the world?

All this may sound hallucinatory now but when Mr Greenspan took over in 1987, who would have predicted the establishment of the euro, or Japan's slide into a decade-long torpor, or how China would change every single calculus about the world economy?

There is no reason to feel Mr Bernanke is not up to the global challenges. But he is sure to be severely tested.

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