Whither International Monetary (Dis-) Order?

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Structure of Presentation

1. Multilateral adjustment and the Bretton Woods deliberations
   - From Bretton Woods to “key currency” system: the dollar as international reserve asset and means of payment
   - From floating and the non-system of dollar dominance
2. Imbalances (again…) and crisis: a turning point and a long transition to monetary pluralism?
3. Can human design help the transition proceed?
   - this might depend on developing widely shared sense of purpose and common interest
   - must it be about power?
4. Who should govern and how? The big, the small, and the middle layers

Multilateral vocation of Bretton Woods…

- Most assume that Bretton Woods was a crowning of the dollar as reserve currency
  - but assumption at the time was that \$ and £ would necessarily share the role of reserve currency, and functions of the City under the Gold Std. would need to be multilateralised
  - Keynes Plan (Bancor, fixed-flex rates, international clearing union, imbalances common concern debtors & creditors, automatic overdraft assistance) was highly multilateral in nature
  - Bretton Woods gold-\$ peg assumed a central role for international organisation (IMF) in monitoring and maintaining exchange rate parities and providing adjustment finance, no int’l reserve asset
- This multilateral vocation was frustrated by events, not by design
  - 1947 winter and British loan, transition to convertibility longer…
  - IMF resources limited relative to need of reconstruction effort
  - \$ only major convertible currency

A key currency system emerges instead

- US the source of aid, trade, functioning capital markets, $ becomes accepted means of payment even in £ zone
  - Marshall Plan and cold war assistance makes US unilateral source of international liquidity
  - Private US FDI and MNC production also reinforces role of $
  - US consumer & capital goods dominates international trade, investment and reconstruction
- New role $ fits with ambitions of State Department rival key currency plan, unexpected economic weakness of others makes it reality
- After convertibility (1959) central bank co-operation displaces the role of the IMF in managing the system

Lessons:

- Idea and proposals for multilateral management of international monetary system not new
- Planning proved difficult, focused on the past, had unintended consequences, and the future proved unpredictable
- A multilateral system failed without economically viable and committed partners
- The global monetary system followed the pattern of trade and investment
- Key currency system was not initially a power play by US, but provided important privileges over time: others finance US self-indulgence, enhanced US power and provides important policy lever
- Fixed rates constrain US most of all: Triffin dilemma liquidity and confidence
- Path dependence: institutionalised market practice and national reserve policies outlive conditions at origins of system as *stricto sensu* US dominance in trade and payments is long over – change takes a long time and requires deliberate action

The move to floating

- Ending gold-$ convertibility *was* a unilateral power play, strengthened and prolonged the role of key currency and increased adjustment costs borne by others
  – others continue to finance US deficit (reserve currency role) but US relieved of responsibility for peg and system
  – US (among others) free riding via devaluation and exchange rate fluctuation
- A bad theory (was not smoothly adjusting, policy autonomy elusive for many, J. Williamson) but suited range of interests at the time
  – good for global financial sector especially when combined with financial liberalisation (traders need bankers to manage new risks of volatility)
  – continuous outflow of dollars & widespread capital account/financial liberalisation boosts availability of finance to public and private
  – governments worry less about deficit finance (for a while)

A Transition Phase (whether we like it or not)?

- Vicious circle : US/UK consume, public and private debt financed by others, surplus and deficit economies share blame & benefits
- Financial opening and careless liberalisation of credit help fuel precarious (if unprecedented) prosperity => too much leverage
- Successive cycles of imbalances 1980s-2007: a clear cost in terms of periodic crisis and volatility especially for emerging markets
- Underlying pattern of trade and payments shifts with rise of EM economies, US economy less dominant but $ more so
- This pattern fuels eventual crisis, suits many governments, investors, and consumers alike
- Change will take deliberate action (problematic), but inertia will lead to a bad solution later as system no longer fits underlying pattern of trade, payments and investment flows
- Self insurance reserves costly
- Repeat cycle of global imbalances and malign neglect yet more risky as debt workout after crisis may take many years

Transition to what?

- A more decentralised international monetary order: a co-operative system of governance is thinkable, is difficult, but may be less risky, less costly for many, than the status quo
  - cost of global finance may be too great without higher degree of co-operation and cross-border governance
  - exchange rate instability perhaps tolerable but not good for trade
- US will/may resist, but it need not be a power issue, but one of functionality of system for real economy, trade
  - there are costs of status quo for US as well as free riding
  - no use providing $ as international reserve to extent its value, stability in question (Volcker), change already happening
  - change should be gradual, $ will remain central for quite some time
  - US *and* surplus countries need to wean themselves off addiction to imbalances,
- Note institutional weakness of euro-zone: deliberate action difficult but not impossible, interest in change and exchange rate stability is clear but limited (low % external trade)
- Spotlight is perhaps on major EM economies as they have greatest interest in more plural system, hold $ reserves, many are open trading economies

Three options:

- Aim is to substitute regional and international co-operation for unilateral US management of the system, as originally planned at Bretton Woods

- Option 1: payments settlement in national currencies between (major) bilateral trading partners or slow transition to multi/reserve system
  - does not require US agreement, but bilateral clearing thus inefficient, high transaction costs, trade and production has global dimensions

- Option 2: set of interlocking regional systems of monetary co-operation shadowing regional patterns of trade
  - could circumvent US disagreement
  - not all trade, finance fits clear regional patterns…
  - but: exchange rate, financial crisis and fallout requires global institutions
  - regional instances require development

Option Three:

- Genuinely multilateral system employing international currency basket unit of account as settlement medium (also *eventually* reserve asset?) as synthetic Euro functioned in Europe for some time
  - sounds like some recent high profile proposals from major EM economy…
  - separate functions of money, priority international trade & payments unit of acct. & medium of exchange
  - initially among central banks, can also be adopted by private sector (trade, bond issues…)
- Unit of account as variable basket of major currencies absorbs some of volatility and adjustment pressures: rate of basket, and national currencies to basket, shifts with underlying trade and financial flows
  - represents diversity because it is a basket, may need more currencies in it
  - avoids need for global agreement on exchange rate regime
  - does not exclude regional patterns of co-operation
  - not a power play unless national governments want to make it so
- The SDR was created for (part of) this role anyway, but national governments never took it up. It is a matter of commitment & active use; IMF can monitor creation of DSRs

The US will not (does not) like it…

- But Volcker (12 June), others, discussed eventual need for international reserve currency and problems, limitations of current role of $
- Still, full multilateral application would require major international agreement: politically difficult and/or unrealistic
- But not all countries need take up the option at first, bilateral-regional and multilateral groups can agree to do so
  - no one needs "permission" to do this, but they do need partners
- So major, broad multilateral agreement not necessary
- Major trading partners e.g. Europe and Asian countries, some Latin American countries, could simply begin to denominate & settle trade in SDR, Asian monetary co/operation can use SDR as unit of account
- Regional exchange rate stability of various degrees is compatible with the idea

Problem is transition

- Diversification long overdue, delay was an oversight, especially when € was low…
- Not helpful to further drive $ downwards
- Also unhelpful to be afraid of the markets: a time of reassertion of public authority needed
- Build SDR and other positions rather than unwinding dollar positions too fast
- This can happen as trade proceeds/picks up and economies improve: quiet but deliberate
- This implies a period of active reserve management, also for corporate treasuries

Remaining but related issues of monetary governance:

- Need for more orderly and institutionalised debt workout procedure has not disappeared, is more urgent, "SDRM" not just for EM economies…
- Capital flows to developing/EM economies still volatile over time, capital flows uphill…
- G20 better than G8, but still not institutionalised or legitimate system of governance
  - large EMs will take place at table regardless;
  - what about middle layers? their interests count too, need to be organised in constituencies: alliance des moyens et petits
  - the weakest members of system still lacking effective representation

Thank You.