

# Can the Dollar-Based System Be Improved or Replaced?

Jeffry Frieden  
Harvard University

# What's wrong with the current system

- Politics, international and domestic
- Two functions: monetary stability and BoP adjustment mechanism
- Both politically controversial among nations
- Neither particularly popular within major nations, especially US

# Global monetary stability

- A public good, hence undersupplied
- Provided by anchor country (in return for privileges)
- Accepted in expectation that anchor country will consider impact of own policy on RoW
- But RoW does not vote in American elections
- Fed largely ignores RoW in favor of its principals – the US government and American voters
- End of BW, EMS crisis as examples – domestic politics trumps international commitments.

# Balance of payments adjustment mechanism

- Smooth functioning requires actual adjustment
- Who adjusts is a distributional question – among + within countries
- (Two) asymmetries of adjustment burden
  - Surplus countries under no pressure to adjust – seemingly unlimited willingness to suppress consumption
  - Anchor/reserve country under no pressure to adjust – seemingly unlimited appetite for safe asset
- Adjustment is domestically painful, politically costly – why do it?
- End of BW; Eurozone debt crisis

# Can the world do better?

- Goal of global monetary stability undermined by anchor (Fed) mandate: US conditions
- Goal of a smoothly functioning BoP adjustment mechanism undermined by unwillingness to adjust (and lack of pressure)
- Can we do better? Sure, normatively
- But positively – is there a Pareto improvement available? Depends on domestic politics
- And American – and other – politics hardly seem favorable to making domestic sacrifices for international goals