International Monetary Reform: What to do Fifty Years after the Collapse of the Bretton Woods System?

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14 April 2023

Men will not always die quietly, and in their distress may overturn the remnants of organization, and submerge civilization itself

John Maynard Keynes, *The Economic Consequences of the Peace*, 1919

Key message

- A well functioning, rules-based international economic system needs leadership.
- This is because:
  - no international order can last without the existence of underlying conditions that minimise competition for markets and resources;
  - leadership is necessary to set the path for a new order;
  - countries need to work together to ensure that the divisions/tensions do not remain entrenched.
- In times of crisis the leader pulls countries together to backstop the crisis and and support the world economy
  - For example, the US call for the G20 in November 2008.

The risks of no-leadership

- The 1929 crisis: no framework for countries to work together and prevent the contagion.
  - "… British inability and the US unwillingness to assume responsibility for stabilizing the international economic system…" (Charles Kindleberger)
- What was needed:
  - a relatively open market for goods;
  - countercyclical long-term lending;
  - liquidity and policy coordination.
- What happened: beggar-your-neighbour policies

Tangled leadership

- The US: the reluctant leader
  - increasingly unwilling to underwrite the provision of economic stability and international security;
  - from a reluctant hegemon to a disruptive one?
- Europe: the in-between
- China: the game-changer

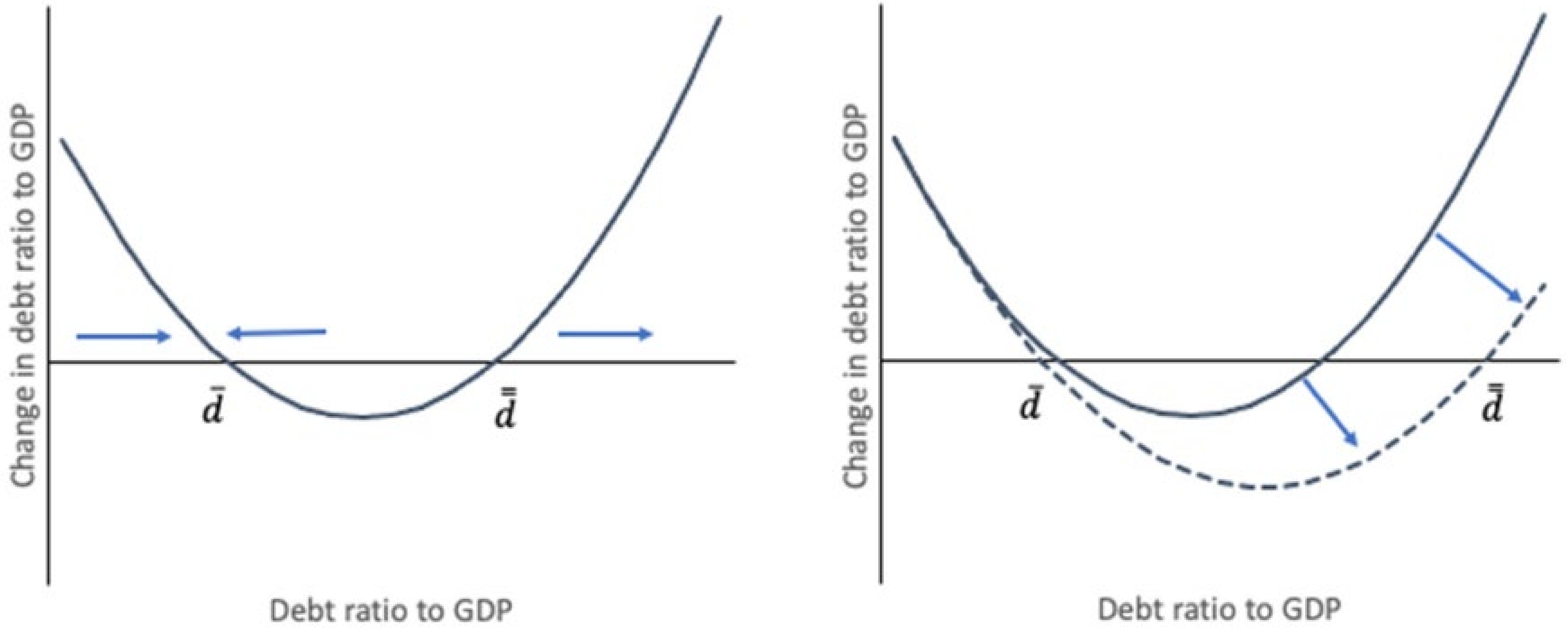
A ‘sticky’ monetary system

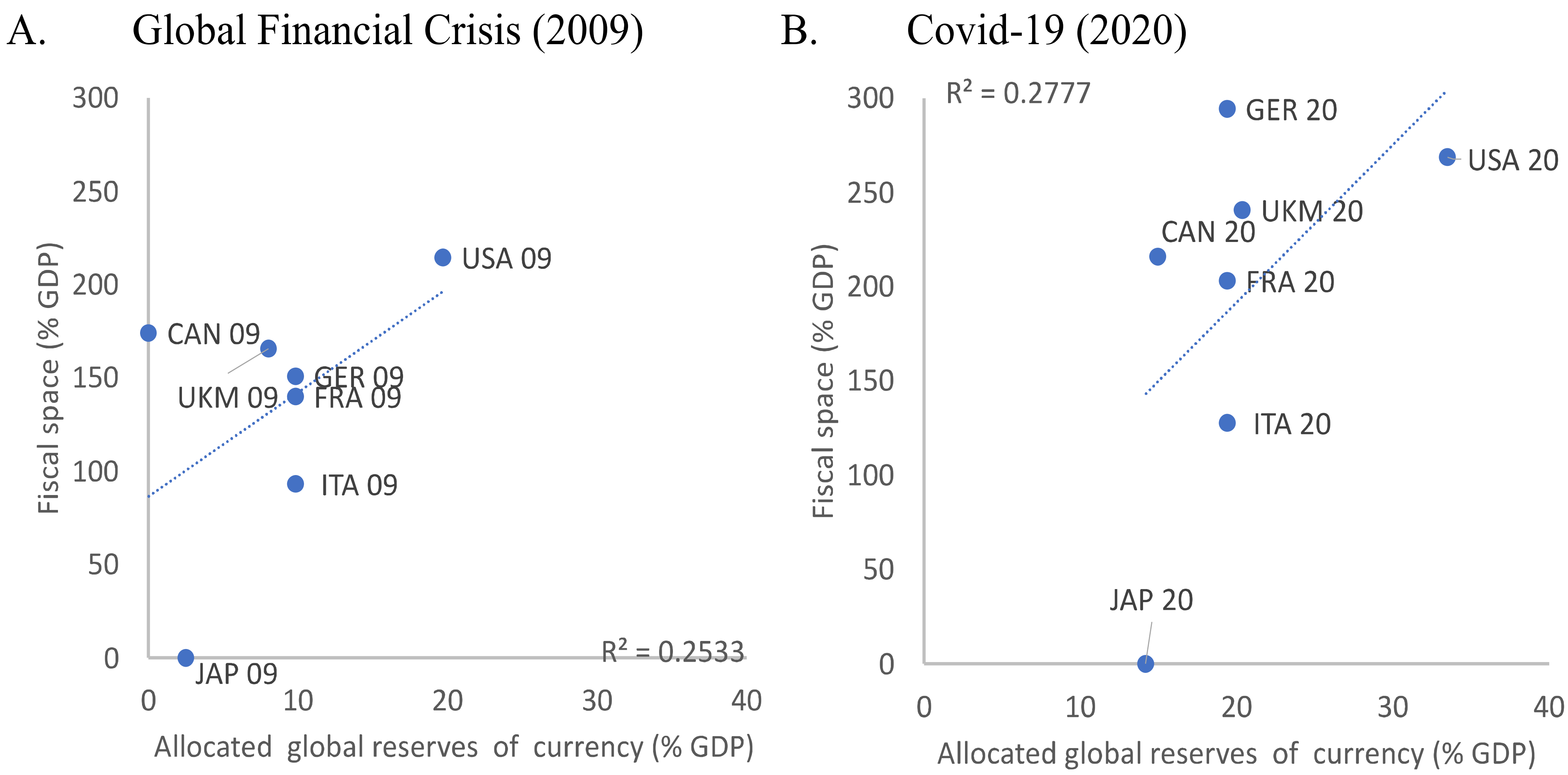
- The dollar continues to glue the world economy together.
- Managed convertibility constraints the RMB internationalisation
  - geopolitics has driven recent shifts in the use and holding of dollars, but only marginally
- Digital currencies?

Exorbitant privilege and fiscal autonomy

- An aspect of the ‘exorbitant privilege’: the ability to run expansionary fiscal policies when a negative shock occurs
  - no adverse reaction of foreign lenders;
  - no significantly higher costs of borrowing.
- The G7 enjoy larger fiscal space than other countries
  - function of countries’ reserve currency status;
  - shield from adverse short-term international capital flows.
- In this paper we use ‘fiscal space’ in a deliberately usual way:
  - max public debt to GDP that a country can sustain trigger an adverse reaction from *foreign lenders.*

A. Baseline B. Increasing reserve currency status




A. Global Financial Crisis (2009)
B. Covid-19 (2020)
Fiscal space (% GDP)
Allocated global reserves of currency (% GDP)
300
250
200
150
100
50
0
0
10
20
30
40
USA 09
CAN 09
UKM 09
GER 09
FRA 09
ITA 09
JAP 09
R² = 0.2533
R² = 0.2777
GER 20
USA 20
UKM 20
CAN 20
FRA 20
ITA 20
JAP 20

A stable IMS requires multilateral cooperation

- To ensure the smooth functioning of the international monetary system:
  - a stronger multilateral financial safety net;
  - enhanced cross-border cooperation between central banks and regulators;
  - cooperation with regional financial arrangements.
- Risk of monetary and financial fragmentation: a zero-sum game.

A stronger multilateral architecture

- Reforms to make the institutional framework more resilient vis-à -vis the changing dynamics of the world economy.
- Enhance policy cooperation on:
  - fiscal policies to stimulate demand and reduce excessive surpluses;
  - regulations to contain financial instability;
  - an international tax framework to remove loopholes;
  - an international ‘green deal’ for environmental sustainability;
  - smart migration policies to mitigate the demographic imbalances in advanced economies.