



THE BRICS AND ASIA, CURRENCY INTERNATIONALIZATION AND INTERNATIONAL MONETARY REFORM

PAPER NO. 1 — JUNE 2013

Global Turmoil: The International Monetary System Today

Benjamin J. Cohen



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This work was carried out with the support of the Asian Development Bank (ADB), Mandaluyong City, Philippines (www.adb.org), The Centre for International Governance Innovation (CIGI), Waterloo, Ontario, Canada (www.cigionline.org) and the Hong Kong Institute for Monetary Research (HKIMR), Hong Kong, China (www.hkimr.org). This work is licensed under a Creative Commons Attribution — Non-commercial — No Derivatives License. To view this license, visit (www.creativecommons.org/licenses/by-nc-nd/3.0/). For re-use or distribution, please include this copyright notice.

Cover and page design by Steve Cross.



CONTENTS

About the Project and Paper Series	1
About the Author	1
Acronyms	2
Executive Summary	2
Introduction	2
Monetary Governance	3
Adjustment	4
Liquidity	7
Confidence	9
Leadership	11
Conclusion	14
Works Cited	15
About ADB	17
About HKIMR	17
About CIGI	18

ABOUT THE PROJECT AND PAPER SERIES

The BRICS and Asia, Currency Internationalization and International Monetary Reform

The disjuncture between global markets and an international monetary system (IMS) based on national currencies generates instability for global trade and finance. As the BRICS (Brazil, the Russian Federation, India, the People's Republic of China [PRC], South Africa) and Asian countries have become more integrated into the world economy, their governments have become increasingly aware of fundamental problems or challenges in the current IMS.

In December 2012, the Asian Development Bank (ADB), The Centre for International Governance Innovation (CIGI) and the Hong Kong Institute for Monetary Research (HKIMR) co-hosted a conference in Hong Kong, China. The conference examined a range of views on the fundamental systemic problems that are a catalyst for international monetary reforms; views from the BRICS and Asian countries, as well as regional considerations regarding the measures that key countries are already taking to respond to the challenges of the IMS, including currency internationalization; and options and preferences for orderly adjustment of the IMS.

The 10 papers in this series, authored by esteemed academic and policy experts, were presented at the conference in Hong Kong, China and were subsequently revised. These working papers are being published simultaneously by all three partners.

ABOUT THE AUTHOR

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ACRONYMS

ADB	Asian Development Bank
BRICS	Brazil, Russian Federation, India, [People's Republic of] China and South Africa
CIGI	The Centre for International Governance Innovation
DM	Deutschmark
EU	European Union
FSB	Financial Stability Board
G7	Group of Seven
G20	Group of Twenty
HKIMR	Hong Kong Institute for Monetary Research
IMF	International Monetary Fund
IMS	international monetary system
PRC	People's Republic of China
SDR	Special Drawing Right
US	United States
WFO	world financial organization

EXECUTIVE SUMMARY

Nearly half a decade after the start of the global economic crisis, the international monetary system (IMS) remains in turmoil. This working paper provides a broad overview of challenges facing the monetary system today, with particular emphasis on problems most directly relevant to the interests of the BRICS (Brazil, Russian Federation, India, [People's Republic of] China and South Africa) and Asian nations. The central challenge is governance — the formulation, implementation, and enforcement of norms for behaviour — in short, the rules of the game. The governance challenge, in turn, may be decomposed into four critical elements: adjustment, liquidity, confidence and leadership. Adjustment is concerned with the resolution of payments imbalances among states and focusses in particular on the key role of exchange rates. Liquidity has to do with the management of the overall supply of financing for payments deficits or related purposes. Confidence is about the composition of liquidity —

specifically, maintenance of trust in the principal instruments of global finance, meaning especially the major international currencies. And leadership is about who is in charge. Since collective rules are unlikely to spring up on their own and certainly are unable to enforce themselves, someone must take responsibility for ensuring that at least some degree of policy coordination is encouraged and sustained. In short, someone must lead. In discussing recent developments and future prospects for each of these four elements, the paper highlights implications for the BRICS and Asia.

INTRODUCTION

Half a decade after the start of the global economic crisis, the IMS remains in turmoil. In Europe, sovereign debt problems threaten the survival of the euro, the European Union's (EU's) grand experiment in currency union. In the United States (US), political dysfunction continues to erode confidence in the dollar, the central linchpin of world finance. Across the globe, growth prospects have dimmed and payments problems have multiplied. And among the emerging market economies of Asia and elsewhere, governments struggle to cope with the volatility of capital flows and exchange rates, feeding worries about the possibility of outright "currency wars." Everywhere, calls are heard for a new commitment to monetary reform. At their latest summit meeting in Delhi, India, in March 2012, the five BRICS nations declared that the "immediate priority at hand [is] an improved international monetary and financial architecture" (BRICS, 2012).

The purpose of this paper is to provide a broad overview of the challenges facing the monetary system today, with particular emphasis on issues most directly relevant to the interests of the BRICS and Asian nations. If the immediate priority is an improved architecture, the essential question, of course, is: How do we construct it? To appeal for

monetary reform is easy, and there is certainly no lack of creative ideas floating around about what needs to be done. The problem, however, is not intellectual creativity, but practical politics — the good old game of power and interests. The central challenge is governance: the formulation, implementation and enforcement of norms for behaviour; in short, the rules of the game. The core issue is: Who will do the governing? Bluntly, who's in charge? At any level of human interaction, the authority to govern rarely goes uncontested. And nowhere is that authority more contested than at the global level, where no central government exists to impose enforceable norms on individual nations.

Like it or not, we live in a world in which politics is organized in terms of territorially defined states, each one formally sovereign within its own borders — a principle going back to the Peace of Westphalia of 1648. Although other international orders have existed in the past and could be conceived for the future (Ringmar, 2012), today it is the Westphalian system that prevails across the globe. In a Westphalian world, the sovereign state is enshrined as the basic unit of political authority. All states are formally equal and there is no higher authority. National sovereignty may not be absolute (Krasner, 1999), but states do all they can to preserve as much practical autonomy as possible. Hence, if any governance is to be exercised at the international level, it must rely on some degree of cooperation, more or less institutionalized, among states — what international relations theorists call “governance without government.” Interstate cooperation has been famously defined by political scientist Robert Keohane (1984) as a mutual adjustment of behaviour achieved through some process of policy coordination. But as we were recently reminded by Jeffrey Frieden and colleagues (Frieden et al., 2012: xvii), “international cooperation is difficult at the best of times, and these are not the best of times.”

The challenge of global monetary governance today, as in all relations between states, is to find ways to promote and enforce effective policy coordination.

MONETARY GOVERNANCE

By long-standing convention, global monetary governance is traditionally seen as comprising three critical elements: adjustment, liquidity and confidence. *Adjustment* is concerned with the resolution of payments imbalances and focusses, in particular, on the key role of exchange rates. *Liquidity* has to do with the management of the overall supply of financing for payments deficits or related purposes. And *confidence* is about the composition of liquidity — specifically, maintenance of trust in the principal instruments of global finance, meaning especially the major international currencies.

To these three elements, I consider it necessary to add a fourth: *leadership*. Collective rules governing such matters as exchange rates or liquidity are unlikely to spring up on their own and certainly are unable to enforce themselves. Someone must take responsibility for employing the traditional means of governance — coercion, bribery or persuasion — to ensure that at least some degree of policy coordination is encouraged and sustained. In other words, someone must lead.

Implicitly, all of this was understood by the negotiators at Bretton Woods in 1944 when they wrote the charter of their new creation, the International Monetary Fund (IMF). A formal governance regime, they concurred, was needed to ensure a degree of order in monetary affairs. Adjustment would work through a system of “pegged but adjustable” exchange rates, as laid out in Article IV of the IMF's Articles of Agreement. Each government was to establish a “par value” for its currency and to maintain its parity within narrow limits, imposing a form of discipline on national policy. Par values could be revised only in the event

of “fundamental disequilibrium.” Liquidity would be provided by the newly created Fund, according to a strict set of quotas and subject to some degree of conditionality. Confidence was not considered an issue, since the principal instrument of financing at the time, the US dollar, was universally regarded as being “as good as gold,” if not better. And no one doubted the leadership of the United States, the dominant monetary power of the day, with Britain as a junior partner.

Underlying it all was an unquestioned belief that for monetary governance to be effective, the regime had to be state-centric. Key decisions should be taken by governments or by an institution, the IMF, with powers delegated to it by its member states, and the rules were to be clear and transparent. Exchange rates were to be established and maintained by national authorities. Likewise, access to payments financing and the terms of that financing were to be controlled by the IMF, acting as agent for the community of nations. And behind it all was a well-understood and accepted structure of leadership, headed by the United States.

Over time, however, much changed to obscure the clarity of the Bretton Woods design, generating ever-greater uncertainty. On the one hand, global financial markets revived, substantially altering the balance of authority between governments and societal actors. On the other hand, the dominant power of the United States gradually faded, leading as well to a wider diffusion of authority among states. Neither development is necessarily undesirable. Indeed, much benefit is derived from both more open markets and less political monopoly. But plainly there are disadvantages, too. As a direct result of both developments, the foundations of monetary governance have been steadily eroded. Prevailing norms have become increasingly opaque, leading to the heightened risk of turmoil that we face today.

With the revival of global financial markets, key elements of the governance regime have become increasingly “privatized.” The move toward floating exchange rates, starting in the early 1970s, effectively meant that for many currencies, values would now be determined by market actors, not governments. Likewise, the re-emergence of international lending via banks and bond markets effectively meant that for countries judged sufficiently creditworthy, access to financing would now also be market-determined. And of course, with capital now freer to move across national borders, vulnerability to destabilizing shifts of confidence among the major currencies has been heightened as well. In all these respects, the system is now ever more exposed to the volatility of expectations and herd behaviour that is so characteristic of financial markets. The price we pay for privatization is a sharper risk of the sort of systemic crisis that we have been living with for the past half decade.

Similarly, with the wider diffusion of power among states, intergovernmental decision making has become increasingly difficult, leaving many problems unresolved. Leadership was a relatively uncomplicated affair when there was just one dominant power with undoubted legitimacy. But the task of coordination has become increasingly challenging as the inner club has expanded, first to the Group of Seven (G7) and now to the Group of Twenty (G20). The larger the designated steering group, the greater the risk of stalemate over divergent interests and the greater the uncertainty over who actually is in charge. Deadlocked leadership, too, can sharpen the risk of systemic crisis.

Can anything be done to improve matters? The answer requires a closer look at each of the four key elements of monetary governance today.

ADJUSTMENT

Begin with adjustment. Once exchange rates began to float, it was clear that the old rules for currency management were defunct. In response, under the Second Amendment of the IMF's Articles of Agreement adopted in 1978, the charter's critical Article IV was revised to lay out a new set of rights and obligations for governments. Out was the uniform "stable but adjustable" formula of par values; in was a new latitude allowing states to choose virtually any currency policy they wanted, from the hardest of pegs to the cleanest of floats, subject only to the admonition that they "avoid manipulating exchange rates...to prevent effective balance of payments adjustment or to gain an unfair competitive advantage." In lieu of the discipline of the par value system, mutual forbearance was now to be the system's prevailing norm. In the one remaining element of global governance, the Fund was directed to "exercise firm surveillance over the exchange rate policies of members" in hopes of ensuring general compliance.

In reality, however, IMF surveillance turned out to be anything but firm, and compliance, as a result, has been anything but general. This has not been for a lack of will. Indeed, as early as 1977, even before the Second Amendment was fully ratified, the Fund sought to specify a series of principles for its exercise of surveillance, including a number of indicators — such as "protracted large-scale intervention in one direction in the exchange markets" — that might trigger a "discussion" with an offending member. To convert principle into practice, a calendar of annual "Article IV consultations" was initiated to keep an eye on possible offenders. But very quickly it became clear that governments were broadly resistant to any sort of serious oversight by unelected international bureaucrats. For the most part, the Fund was

effectively marginalized, leaving states more or less free to do their own thing.

Not surprisingly, therefore, abuses have accumulated, as more governments learn to enjoy the freedom to manage their exchange rates as they see fit. Some intervene openly in the exchange market, using central bank reserves to steer currency movements. Others rely on more indirect levers, such as interest rates or even newly fashionable capital controls. Especially since the start of the current global crisis, "dirty floats" have become increasingly prevalent, inhibiting adjustment and exacerbating currency volatility. Should we be shocked, then, by growing talk of "currency wars"? The term "currency war" was popularized by Brazil's Finance Minister Guido Mantega who, as early as 2010, began to complain about what he saw as efforts by key governments around the world to push down their exchange rates to boost exports. "We're in the midst of an international currency war, a general weakening of currency," Mantega charged. "This threatens us because it takes away our competitiveness" (Garnham and Wheatley, 2010). Today, many states may fairly be accused of exchange rate manipulation.

For Brazil and the other BRICS, the biggest offenders are the United States and Europe, where expansionary monetary policies and historically low interest rates have spawned a flood of capital exports seeking higher returns wherever possible. Though such policies could be justified by a need to fight the risk of recession at home, they have been seen elsewhere as an indirect form of competitive devaluation at the expense of capital importers. In the words of the BRICS leaders, in what they called the Delhi Declaration issued after their meeting in March 2012, "excessive liquidity from the aggressive policy actions taken by central banks to stabilize their domestic economies have been spilling over

into emerging market economies, fostering excessive volatility...We believe it is critical for advanced economies to adopt responsible macroeconomic and financial policies [to] avoid creating excessive global liquidity." In this context, responsibility seems to be equated with doing nothing that would drive up the value of emerging market currencies.

For the advanced economies, by contrast, this is really more a case of the pot calling the kettle black. In fact, among the most blatant exchange rate manipulators are the BRICS themselves, along with such influential Asian nations as Singapore, the Republic of Korea and Taipei, China. According to a recent study published by the influential Peterson Institute for International Economics (Gagnon, 2012), the worst examples of currency manipulation around the globe today are to be found among the emerging market economies, including two of the BRICS (PRC and Russian Federation) and no fewer than eight Asian economies. Ironically, one of the most overt currency warriors has been Guido Mantega's Brazil, which has openly experimented with a form of capital control to limit appreciation of its money, the real. Brazil's strategy took the form of a financial transactions tax on credit inflows, first imposed in 2010 before being recently relaxed. The most obvious culprit, however, has been the PRC, whose determined efforts to hold down the value of its currency, the yuan, also known as the renminbi (RMB or "people's currency"), eventually resulted in the biggest buildup of exchange reserves in history, now worth well in excess of US\$3 trillion.

Precisely because of the PRC, the IMF moved in 2007 to update its principles of surveillance, adding "external stability" to the list of criteria for judging policy behaviour. External stability meant avoiding payments imbalances that might generate disruptive currency movements. In addition to protracted large-scale exchange intervention, indicators

of misbehaviour would now include "excessive" reserve accumulations, "fundamental exchange rate misalignment" and "large and prolonged surpluses" — all obviously aimed at Beijing (and adopted over Chinese objections). Additionally, in 2009, the Fund was directed by the G20 to monitor a new Mutual Assessment Process among its members, a critical cornerstone of a grand pledge by the G20 to promote a "Framework for Strong, Sustainable and Balanced Growth." Henceforth, the IMF was to provide "candid, even-handed and balanced analyses" of policies, and to publish regular "spillover reports" on the world's five most systemically significant economies — the United States, the United Kingdom, the euro zone, the PRC and Japan — in an effort to forestall policy inconsistencies or the spread of negative externalities. In summer 2012, spillover assessments were extended to be an integral part of all Article IV consultations, and a new *Pilot External Sector Report* was issued by the IMF to provide a multilaterally consistent analysis of the external positions of major economies.

Yet for all its efforts, the Fund's impact continues to be spotty at best, as the institution itself acknowledges. In November 2011, following its latest Triennial Surveillance Review, the IMF executive board ruefully admitted that, still, "the current legal framework does not sufficiently account for economic realities." In particular, surveillance was found to have less impact for larger member countries, such as the BRICS, than for smaller economies. Although the PRC is the target utmost on everyone's mind, Beijing remains adamant in its refusal to modify its currency practices.

Why has IMF surveillance been so ineffective? Plainly, it has much to do with the inability of a multilateral agency, however well respected, to impose its will on national governments jealous of their sovereignty. Except for countries that are in desperate need of

finance, the Fund lacks even the most rudimentary means to enforce norms or sanction members for non-compliance. At best, all it can do is offer guarded commentary, which seems to have little impact on practical behaviour. Were the IMF to be granted truly effective supranational powers, the risk of currency wars would be greatly reduced. But, frustratingly, that seems far beyond what member states, including the BRICS, are prepared to accept.

In short, the outlook does not look promising. After their March summit, the BRICS leaders “call[ed] upon the IMF to make its surveillance framework more integrated and even-handed.” Noticeably absent from the Delhi Declaration, however, was any clue as to how that might actually be accomplished. Left unasked was the question: Would the BRICS themselves submit to tighter IMF surveillance? Or was “even-handedness” meant for others, not themselves?

LIQUIDITY

The outlook does not seem much more promising when it comes to the management of liquidity. Once banks and bonds had supplanted the IMF as the major sources of financing for a broad range of nations, the overall supply of liquidity effectively became hostage to the vagaries of international investor sentiment, which can, as we know, ebb and flow like the tides. The challenge of governing liquidity gradually merged into the broader question of how to maintain stability in global financial markets.

There is no question that capital markets perform many valuable functions, helping governments and societal actors alike to supplement financial resources, when needed, or to diversify risk. However, there is also no question that, too often, investor behaviour turns out to be pro-cyclical — rushing to make credit available when times are good,

then fleeing the scene like so many lemmings when the going gets rough. Emerging market economies that have opened their financial systems to foreign investors are particularly vulnerable to inward or outward surges of capital. Although impacts may be buffered somewhat by more flexible exchange rates and a closer attention to macroeconomic fundamentals, as a recent IMF study notes (Adler and Tovar, 2012), the results can, nonetheless, be painful. Many countries are left prone to repeated crises, often quite intense and prolonged, which destabilize economies and sap growth. This problem was also highlighted in the BRICS Delhi Declaration. “We draw attention to the risks of large and volatile cross-border capital flows being faced by emerging economies,” the BRICS leaders said. “We call for further international financial regulatory oversight and reform.” But here, too, the exhortation was notably lacking in specifics. In fact, the international community has yet to find a way to temper the risk of financial crises or to cope with them adequately when they recur.

The pattern is sadly familiar. We saw it in the 1970s, when banks optimistically poured money into Latin America, only to recoil in the 1980s, contributing to what Latin Americans still recall as a “decade of lost growth.” We observed it again in the early 1990s, when bond markets opened the sluice gates to emerging economies, leading ultimately to a series of crises inter alia in Mexico (1995), East Asia (1997-1998), the Russian Federation (1998), Brazil (1999) and, finally, Argentina (2001). Most recently, we witnessed it in the worldwide lending boom of the early 2000s, which, as we know, soon triggered the biggest financial collapse since the 1930s and led directly to today’s sovereign debt problems in Europe. Such cycles seem to be built into the DNA of capital markets. For Asians, the humiliations of the 1997-1998 crisis, when they were forced to kowtow to the diktat of the IMF, remain a searing memory.

Also sadly familiar is the pattern of failed response by the international community, which, after each episode, pledges yet again to find effective means to reduce the risk of crises and to manage them better, only to fall short of what is needed. The best that governments seem to be able to do is open up new sources of liquidity to better defend themselves against adverse market pressures. So it was after the troubles of the late 1990s, when there was also talk of reforming the international financial architecture, as it was then newly called. Efforts soon came to naught. Apart from additional resources for the IMF, the only tangible result was the creation of the Financial Stability Forum — later renamed the Financial Stability Board (FSB) — gathering together top financial officials from some two dozen countries and a variety of international institutions to share information and coordinate policy initiatives. And so it appears again today, despite the best of intentions. The IMF, G20 and FSB have all promised fervently to strengthen global rules for financial supervision and to enhance multilateral collaboration to reduce the scope for regulatory arbitrage. To date, however — apart, once again, from new resources for the IMF — remarkably little has actually been accomplished.

Admittedly, some national legislation has been passed, most notably the Dodd-Frank bill in the United States as well as new reforms in Britain and the European Union. However, few observers would contend that, on their own, these initiatives are anywhere near enough to ensure greater financial stability; already there is much evidence of vigorous “push back” by financial interests determined to preserve as much freedom of action as possible. At the international level, new regulatory standards for financial enterprises — dubbed “Basel III” — have been agreed upon by the Basel Committee on Banking Supervision. Negotiated in 2010-2011, Basel III sets higher levels for bank capital adequacy ratios

and introduces new regulatory requirements on bank liquidity and leverage. But with full implementation of the new rules to be delayed until as late as 2019, there remains considerable uncertainty over how much impact the modified standards may ultimately have.

Nowhere has the failure of response been more glaring than in Europe’s desperate efforts to come to grips with its sovereign debt troubles. Since the threat of default first erupted in Greece in late 2009, leaders have repeatedly met to announce a “comprehensive” solution, only to fall short of their goal. Rescue packages were thrown together to bail out Greece, then Ireland and Portugal, but in amounts and on terms that were insufficient to stop market pressures from spreading to Spain, Italy and others. In 2012 alone, there was a second rescue for Greece, accompanied by a massive write-down of privately held Greek debt and new rescues for Spain and Cyprus. As early as 2010, a temporary European Financial Stability Facility was established by members of the euro zone to provide a “firewall” against financial contagion, to be followed later in 2012 by a permanent European Stability Mechanism, but with funding that has persistently proven to be inadequate. And new capital requirements were promulgated for European banks, but at levels that provided no sure protection against the risk of fatal insolvencies. At each step, governments have persistently lagged behind the curve, always one or two steps short of what was needed. Strategy has been reactive and incremental, seemingly meant to do little more than buy time. One is reminded of the Dickens character Mr. Micawber, who optimistically lived in hope that one day “something will turn up.” But something has yet to turn up. As this paper is written (November 2012), the European crisis continues to fester painfully.

None of this is for lack of intellectual creativity, of course. The analytics of monetary crisis are well understood, and since the beginning of our current troubles, all kinds of imaginative ideas have been floated for reform from a variety of public and private quarters. At the level of national policy, as noted, capital controls have become newly fashionable, reversing decades of disapproval. Until recently, advocacy of capital controls was viewed as something akin to heresy (Cohen, 2004: ch. 4). Today, by contrast, even the IMF has come around to the view that, in selected circumstances, the “use of capital controls... is justified as part of the policy toolkit” (Ostry et al., 2010), particularly to help manage surges of capital inflow. At the international level, proposals have ranged from a new emphasis on so-called “macroprudential regulation” to a broad-based tax on financial transactions — all intended to reduce the pro-cyclicality of market lending and thus limit the risk of future turmoil.

Likewise, to help manage possible disturbances more effectively, a variety of institutional innovations have been suggested, ranging from improved lender-of-last-resort facilities at the IMF or elsewhere to some kind of global debt-restructuring agency. Economist Barry Eichengreen (2009) has even gone “out of the box” to contemplate the possibility of an entirely “new world financial organization” (WFO), parallel to the already existing World Trade Organization, to establish binding commitments to common standards for prudential supervision and regulation. On purely economic grounds, many such proposals make perfectly good sense.

The problem, as always, is politics — the demands of national sovereignty, with all their inevitable compromises and accommodations. Governments have been resistant to any step that might disadvantage their own economy or the interests of key domestic constituencies. Why, for example,

should we believe that states would be any more amenable to the strictures of a WFO than they are now to the surveillance procedures of the IMF? Even in Europe, which has been chipping away at national sovereignty for well over half a century, leaders find it difficult to subordinate their divergent preferences to common objectives. Is it likely that the BRICS nations — above all, the PRC, with its tightly controlled markets — would be any more favourably disposed toward outside intervention in the management of their internal finances? Very little in recent history gives us reason to anticipate the kind of decisive collective action that would be required to truly tame the global system’s repeated bouts of *sturm und drang*.

CONFIDENCE

With the privatization of the monetary regime, it is not just the overall supply of financing that has become hostage to the vagaries of investor sentiment. So, too, has the *composition* of liquidity, meaning the relationship among the principal instruments of financing. Even apart from their role as a source of credit, banks and bond markets can destabilize the broader system through sudden shifts of confidence among major currencies. Regrettably, here too governments have yet to find a way to temper the risk of turmoil.

Of course, no such risk would arise if there were just a single world currency, issued and managed by the equivalent of a global central bank. It is obvious that for the world economy to flourish, some kind of internationally acceptable money is needed. Otherwise, states would be reduced to crude barter, severely limiting gains from cross-border trade or investment. From an efficiency point of view, a single supranational currency would seem to make the most sense, since transactions costs would be minimized. As Nobel laureate Robert Mundell has quipped, the optimum number of currencies is like

the optimum number of gods — “an odd number, preferably less than three.” But can anyone seriously believe that in our fragmented Westphalian system, credible agreement can be reached on the terms for the creation and management of a genuine global money? From a political point of view, the option seems unattainable, even risible. Much more realistic is the prospect that the world economy will continue in the future, as it has in the past, to rely mainly on a limited selection of national currencies to play vital international roles. Hence, it is realistic to assume that the confidence problem will remain a salient issue as well.

The closest we have ever come to a single world currency was at the time of the Bretton Woods conference, when the US dollar was without a serious rival as international money. (Britain’s pound was also used internationally at the time, but only within the tight confines of the sterling area.) In the immediate postwar period, trust in the US greenback was unsurpassed, encouraging acquisitions. The dollar was “as good as gold,” if not better. By the 1960s, however, as US liabilities continued to mount and the US Treasury’s gold stock began to shrink, worries crept in, leading economist Robert Triffin to formulate his notorious “dilemma” — the increasingly obvious fact that the global economy’s need for reserve growth and the United States’ need to sustain confidence in the dollar were mutually incompatible. The world could not continue to rely on US payments deficits to expand international liquidity without risking a flight from the greenback. In large part, the IMF’s Special Drawing Right (SDR) was created to deal with the Triffin dilemma, although not in time to prevent the crisis in 1971 that led Washington to terminate the dollar’s link to gold.

In the four decades since, new rivals have occasionally emerged to challenge the dollar, including, for a time, Germany’s Deutschmark (DM), later Japan’s

yen, and most recently Europe’s euro (replacing the DM). And just over the horizon looms the Chinese yuan, which many see as the international money of the future. No currency at the moment, however, comes even close to replacing the greenback at the peak of what I have elsewhere called the “Currency Pyramid” (Cohen, 1998). America’s money is still the linchpin of global finance. Its top position may be weakening under the weight of Washington’s dysfunctional politics and worrisome accumulation of debt, but neither is there any obvious new leader lurking in the wings, just waiting to take centre stage. Instead, we find ourselves gradually moving toward a more fragmented monetary universe, with several currencies in contention, but none clearly in the lead — what may fairly be called a leaderless currency system (Cohen, 2011: ch. 9).

For many, the arrival of the dollar’s new rivals is a welcome development. A broader multi-currency system, it is argued, will widen the range of choice for market actors, thus making it harder for the United States to act in an arbitrary, unilateral fashion. For years Washington has been criticized for exploiting the “exorbitant privilege” of something close to a de facto monopoly, putting the exigencies of its own balance of payments and borrowing needs above any concern for systemic stability. The result, it is said, has been the long-term erosion of trust in the dollar and periodic bouts of monetary disorder — in effect, a new version of the old Triffin dilemma. Once viable alternatives are available, however, it can be expected that greater discipline will be imposed on US policy. Washington will be compelled to pay more attention to the risk of capital flight and, therefore, will have more incentive to accommodate the interests of others. In the words of C. Fred Bergsten (2011), a prominent advocate of a wider mix of global currencies, “pressure from abroad can be constructive in promoting needed adjustment” in the United States. In principle, American exceptionalism

would at last be curbed, imparting more stability to the system.

The case for a broader multi-currency system has been especially popular in the emerging market economies of Asia and elsewhere, where resentment of America's "hegemony" in monetary affairs is long standing. Considerable legitimacy for the argument was provided in 2009 by Zhou Xiaochuan, governor of the People's Bank of China (the PRC's central bank) in a widely publicized speech entitled "Reform the International Monetary System." The world, Zhou contended, needs an international currency system "that is disconnected to individual nations and is able to remain stable in the long run" (Zhou, 2009). In plain English, the world needed to reduce its undue dependence on the US dollar. Most attention, initially, was placed on what Zhou had to say about prospects for the SDR as an alternative to the greenback. It soon became clear, however, that what he really had in mind was a gradual transition toward a multipolar monetary system more in keeping with what is widely seen as a newly emerging balance of power in global politics. According to one authoritative commentary (Chin and Yong, 2010: 4), this was a "game-changing moment." Since then, the theme of currency multipolarity has become a persistent feature of the BRICS agenda. In the words of the communiqué issued after the third BRICS summit in Sanya, the PRC, in 2011, "we support...a broad-based international reserve currency system providing stability and certainty" (BRICS, 2011).

But stability is by no means the only possible outcome. In practice, regrettably, discipline across the system might well be weakened rather than strengthened. Again, the reason is politics. For every issuer of an international currency, the imperative remains the same. National interest must be balanced against international responsibility — a delicate task, at best — and there is no guarantee that other

newly empowered countries might not also seek to enjoy an exorbitant privilege, narrowly prioritizing their own interests. Since Zhou Xiaochuan's speech, for example, the PRC has accelerated a concerted campaign to promote internationalization of the yuan (Cohen, 2012). Why should the Chinese also not want to enjoy the privileges of international currency status? In a multi-currency system, the challenge posed by the Triffin dilemma is, if anything, multiplied. Effectively, banks and bond markets will be given even more scope to bet for or against individual currencies. As more monies compete at the peak of the Currency Pyramid, the risk of destabilizing shifts of confidence could be greater than ever.

LEADERSHIP

In sum, the outlook for the three traditional elements of monetary governance is anything but promising. Current provisions for surveillance of exchange rate policies seem inadequate to prevent possible currency wars. The management of the supply, as well as the composition, of liquidity remains hostage to investor sentiment. Yet none of these challenges is necessarily insurmountable — if only there were sufficient leadership to promote effective solutions. So why has no one led? Why has the requisite policy coordination been so difficult to organize?

Certainly, the circumstances have seemed propitious. When the current global crisis first broke, following the collapse of the US housing bubble in 2007, the benefits of cooperation could not have been more obvious. The world was teetering on the edge of disaster — a second Great Depression, or worse. Not unreasonably, therefore, hopes were high that events might provide the necessary catalyst for a fundamental reordering of monetary affairs. Attention focussed on the G20, freshly empowered to act as a steering group for the world economy. Many spoke of a new "Bretton Woods moment" —

once again an opportunity, like that at the original Bretton Woods conference in 1944, to reshape the design of the international financial architecture.

Such hopes were not necessarily misguided. Obviously, arranging the necessary agreement would not be easy. New international commitments, by definition, would impose limits on the autonomy of financial policy, which governments prize for its importance to economic management at home. It is for that reason that, when conditions are relatively calm, the desire to maintain control of domestic monetary conditions typically prevails. But these were not “normal” times. In moments of crisis, when all are faced by common dangers, calculations may well shift, as I have noted previously (Cohen, 1993). At such times, governments often demonstrate a willingness to relax their resistance to compromise. Given all that seemed to be going wrong once the US housing bubble burst, it was only natural that many might look to the “old” Bretton Woods for inspiration. If effective reforms could be agreed then, why not now?

Unfortunately, those who dreamed of a new Bretton Woods forgot what it took to make the success of the old Bretton Woods possible. From a small ski resort in New Hampshire came an outcome that was truly historic — for the first time ever, a fully negotiated regime to govern global monetary relations. Looking back, it is clear that two factors were paramount (Andrews, 2008; Cohen, 2008). First was an unusual degree of consensus on basic principles, which made it easier to sweat the details. Delegates, we know, were not agreed on everything. Bitter fights were fought, for example, over some of the powers to be granted to the new IMF they were creating. But on the fundamentals, such as the nature of the exchange rate regime or the need for an adequate supply of liquidity, there was a striking coincidence of views. And second was effective leadership by the dominant

monetary powers of the day, the United States and its junior partner Britain. Before the conference, stretching back more than two years, an arduous process of preparation was led by two key Treasury officials, America’s Harry Dexter White and Britain’s John Maynard Keynes. Without their determined efforts, which managed to resolve most, if not all, the issues on the table even before the meeting started, it is doubtful that the delegates could have achieved what they did.

Contrast that with the deliberations of the G20 over the past half decade. At the outset, participants did manage to agree on some common policies, including, in particular, programs of fiscal stimulus by everyone concerned. But that was more akin to what Keohane (1984) described as harmony — a spontaneous coincidence of preferences—rather than cooperation in the sense of a true mutual adjustment of behaviour. With the prospect of a new Great Depression looming, it was not hard to conclude that spending increases were needed all round. In the years since, by contrast, as divergent interests have reasserted themselves, accomplishments have been thin. Meetings have occurred regularly and detailed communiqués have been issued, replete with high-minded pronouncements of principle; sometimes grand new initiatives have been announced, like the “Framework for Strong, Sustainable and Balanced Growth” and its associated Mutual Assessment Process. But with all the fine words have come few tangible demands. For the most part, policy makers simply return home and continue to go their own way. The only exceptions have been Greece and other heavily indebted countries at the periphery of the euro zone that have been forced by their creditors to acquiesce to costly austerity programs. Overall, it is fair to say, effective monetary governance in the recent period has been most conspicuous by its absence.

The reasons are obvious. Neither of the factors that were so influential in 1944 are in evidence today. As Eric Helleiner (2010: 619, 636) has perceptively noted: “The success of the Bretton Woods conference was a product of a remarkable combination of concentrated power in the state system [and] a transnational expert consensus...The political conditions that generated the innovations of Bretton Woods were unique and are not present today.”

On the one hand, power is no longer so concentrated, further inhibiting agreement. In monetary affairs, power has two dimensions: *autonomy*, an ability to act without restraint, and *influence*, an ability to change the behaviour of others (Cohen, 2006). In 1944, the United States enjoyed unparalleled power in both respects, giving it an unprecedented capacity for leadership. But those days are long gone, as the new prominence of the G20 testifies, formally incorporating the BRICS and others into prevailing leadership councils. Today, monetary power has become much more widely diffused. The increase of numbers at the table is challenge enough. Worse is the fact, as I have noted elsewhere (Cohen, 2011: ch. 10), that the diffusion of power has been mainly in the dimension of autonomy rather than influence. While the BRICS and some Asian nations have gained a degree of insulation from outside pressures, few as yet are able to exercise greater authority to shape the rules of the game, hence few are willing to take the responsibility to lead, which can be burdensome. For now, the larger emerging market economies seem content simply to enjoy their newfound ability to do their own thing, to the extent possible, with little regard for the preferences of others.

On the other hand, consensus has clearly broken down. Leading governments seem unable to agree even on what the most important problems are, let alone how to deal with them. Some stress the anarchy of the exchange rate regime, others

the unpredictability of financial markets or the still exorbitant privileges of the dollar. Should the authority of the IMF be enhanced? Should the influence of investors be curbed? Should a multipolar currency system be promoted? The questions seem endless, and G20 policy makers have not even begun to figure out how to answer them. Even within the smaller BRICS group, where just five governments are involved, consensus has proved elusive, as the bland wording of their annual summit communiqués testifies. Recommendations tend to be posed at the loftiest level of generalization, avoiding specifics. Platitudes dominate. Who could possibly disagree with a call for more “responsible” macroeconomic policies or more “effective” financial regulation? Who could deny the need for “positive results”?

In fact, the BRICS find it much easier to concur on what they do *not* like — for example, the still lingering dominance of the dollar — than to find common ground on what they would like to see *instead*. In terms of tangible proposals, they seem able to agree on just one imperative: a need for quota reforms at the IMF to increase their share of voting power. Under the 2008 Amendment on Voice and Participation, which came into effect in 2011, the votes of the five BRICS went up from 10.448 percent of the total to 11.013 percent; once a subsequent round of quota increases negotiated in 2010 goes into effect, their share is scheduled to rise again, to 14.139 percent, nearly equal to America’s 16.479 percent. The PRC alone will have the third-largest share of any nation, behind the United States and Japan (6.138 percent), the Russian Federation will be in tenth place, India in eleventh and Brazil will be at number 14. Yet, the BRICS all concur that still more increases are necessary, as the Delhi Declaration put it, “to better reflect economic weight [and] ensure the legitimacy and effectiveness of the Fund” (BRICS, 2012). One might wonder why so much energy has been put into the issue of voting rights in an organization

where almost all decision making, in practice, is done on the basis of consensus. It is almost as if considerations of prestige and national pride take precedence over more substantive issues such as surveillance or crisis management. It certainly does not look like leadership.

CONCLUSION

What, then, is the outlook for the monetary system? Overall, the challenges facing the international community are formidable. To say the least, conditions would not appear to be ripe for extensive reform. However, that does not mean that no improvements are feasible. It means only that hopes should not be unrealistically high. Aspirations must accept the limits imposed by the nature of the Westphalian system in which we live.

In the Westphalian system, reform does not come about without a struggle. As the Bretton Woods experience suggests, what is needed is an effective political strategy combining two critical elements. First is the need to find some common ground on key issues that goes beyond vague pronouncements of principle. Second is the need to assemble a winning coalition of influential states. All that is easier said than done, of course. But when the alternative could be yet more turmoil, neither element seems entirely out of reach. The BRICS and Asian nations, with their growing economic weight and prominence in the G20, are in a position to play a constructive role in developing such a strategy. Their influence could be considerable if they could only move beyond a preoccupation with their IMF quotas to develop more tangible prescriptions for what ails the system.

My guess is that as the threat of turmoil looms ever larger, some modest improvements are likely to emerge over the medium term. To make exchange rate surveillance at least a bit more effective, for instance, the IMF may well be given some additional

authority to “name and shame” errant governments, as Jeffrey Chwieroth (2010) has proposed, in hopes of persuading policy makers to mend their ways. Likewise, governments can be expected to continue to tinker with their regulatory systems to temper the dangerous volatility of financial markets, as Randall Germain (2010) has suggested. And, as monetary power continues to diffuse, the BRICS and others are likely to come to appreciate the need to share in the responsibility of leadership. Some semblance of governance will be provided.

But it will be imperfect governance. Even more than it does now, the IMS will come out looking something like the proverbial camel — a horse designed by a committee. The patchwork will not be pretty. But even a distinctly suboptimal outcome will be preferable to no action at all. Better to muddle through than to succumb to crisis.

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