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PAPER

COMMENTS ON THE BOOK “TOWARDS A RENEWED BRETTON WOODS AGREEMENT”

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Comments on the book by Giovanni Tria and Angelo Federico Arcelli
“Towards a Renewed Bretton Woods Agreement”

By Lorenzo Codogno

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The paper is a well-documented analysis and historical account of developments in the international monetary system, from the Gold Standard to Bretton Woods in 1944 to the so-called Second Bretton Woods after the suspension of US dollar convertibility in 1971.

Since 1971, there has been an “anarchic” non-system, with some currencies free floating and others pegged to the US dollar. There has also been a search for stability. The European response was the launch of the European Monetary System in 1979.

Since WWII, the US dollar has maintained its role and the United States its “exorbitant privilege”. The US economy has moved from accounting for almost 50% of global GDP to 20%. Still, the “tailors” around the world became more important over time, and they were de-facto forced to lend their revenues.

Is it time for a new international economic order? The issue is whether the tailors’ growing importance around the world will lead to an Emperor without clothes, i.e. the US dollar being dethroned in favour of a new global currency or a multipolar system.

The paper mentions the development of more integrated systems in Asia and Europe. These developments did not challenge the central role of the US dollar in the international financial system. Even when China left a fixed exchange rate with the US dollar and capital controls in 2005, the situation did not change much. The paper argues that the two sides of the Pacific neutralised any adjustment mechanisms of fixed exchange rate imbalances, which traditionally happen through shifts in relative prices.

The Great Financial Crisis challenged the US dollar’s role again, and the same seems to be happening today, following the pandemic crisis.

Since 2008, China has re-oriented production domestically, and thus it has less need to fix the exchange rate to the US dollar, although in time of crisis still has this option. China is no longer willing to finance the US trade deficit, probably preferring to finance emerging markets and commodity producers.

The debate on a global currency, triggered mainly by the IMF before the Great Financial Crisis, led to the Chinese Central Bank governor Zhou Xiaochuan’s statement on the use of SDRs as a global currency. The paper argues that the issue was not sorted out at that time. The Fed injected massive amounts of liquidity to counteract the crisis, resulting in substantial capital flows into emerging markets with destabilising effects.

The regular report by the European Central Bank on the global role of the euro shows that despite the diminished role of the US economy globally, the US dollar is still the dominant currency on many counts. The paper calls it a network effect. There is probably much more than that.

The US Administration is the only player that can undermine the US dollar’s role, and by the way, it was already moving in that direction before the recent US elections. In fact, a new threat came from the Trump Administration, as it undermined the multilateral organisations that underpin the US dollar’s role

internationally. In 2020, the US Administration was even trying to weaken the dollar through verbal intervention.

Meanwhile, China started to develop its own network through the Belt & Road Initiative, new international organisations, and the financing of emerging markets. Nobody knows how big the Chinese financing of emerging markets is now, but it is undoubtedly massive. Effectively, it is an alternative network with different rules and governance.

Therefore, the question is whether a new economic order will emerge from the pandemic crisis.

The 2008 crisis did not undermine the US dollar role as a global safe asset, although the financial shock came from the US. The paper argues that there is a new debate about a global currency, a new *bancor*. However, who has an interest in that?

The strategic and geopolitical clash between the US and China is increasingly addressed by building alternative networks, which are nowhere near the point of undermining the central role of the US dollar, especially given the attitude of the new US Administration. De facto, the challenge to the US dollar can only come from the US itself.

The paper argues that three factors make a reform of the global monetary system urgent:

- 1) The strengthened role of China, and its trade relationships, combined with the possible retreat from hyper-globalisation. There is no strong evidence so far of de-globalisation, but there may be a shortening in the global supply chains. Trade flows are partly moving from China to other Asian countries because of the diversification of suppliers. Is there a decrease in global trade relative to GDP? So far, there is no evidence for such de-globalisation, but only some evidence of stabilisation. Is there a risk of “de-coupling”, i.e. reduced connections between the US and China? The paper says this would be a devastating and impossible phenomenon, and I would agree. There is a need to preserve global trade. A multipolar world is gradually developing anyway and is not preventing trade.
- 2) There is a risk that the US dollar’s dominant role in the international financial infrastructures becomes a geopolitical tool, the so-called “weaponisation” of the dollar, which could undermine investors’ confidence in the currency as a safe asset. However, as I argued, this threat can only come from the US Administration attitude towards the US dollar, not from the outside.
- 3) The third reason is technology and its role in the global payment system. Cryptocurrencies show the feasibility of a global currency. However, they also show the feasibility of global competition among currencies. Globalisation is based on technological standards, which naturally tends to lead to a de-facto monopoly power for a few “networks” (Amazon in logistics, for instance). The US dollar is a crucial ingredient for the dominance of the US economy and US multinational companies.

The paper calls for a New Bretton Woods agreement. The question is, “what should the West do to build a new global order for a future of peace and worldwide economic growth?” The answer differs. In Europe, it is the so-called “strategic autonomy” the supposed answer. Is it a viable proposition? Europe is extremely weak on many counts, and not least in military and geopolitical reach. In the US, the issue is different. Why should the US give up its global dominance through the US dollar? For the US, it is all about the containment of China. Why would the US give up such a power?

Finally, at the moment, there is no credible replacement for the US dollar. Mohamed El-Erian summed it up by saying: “It is difficult to replace something with nothing”.

Arguments in favour of global currency are overwhelming in my view (including Carney’s). Currently, it is a vulnerable “neural network”. It would be a sort of common good for the global economy, but it would impinge on the dominant role of the US dollar, which seems unlikely.

Can we move from the hegemonic power of the US dollar to a “hegemonic synthetic currency”? Again, why would the US be willing to give up the dominant role of the USD?

The paper says “a lot may depend on the US openness to consider some limitations of the exorbitant privilege position”. Nevertheless, either the US dollar remains the global currency, or the privilege would be gone.

Thus, how can the situation change? Currently, the system is too imbalanced; only with a change in the global equilibrium, the situation will change, i.e. probably not before 20-30 years.

The shale oil/gas revolution, making the US energy self-sufficient in 2019, reduced the US current account deficit. With green technology and the environmental shift, the US may no longer be in the driving seat, but it will take years, if not decades.

President Nixon’s Treasury Secretary John Connolly famously said in 1971: “The dollar is our currency, but your problem”. We have seen how important it is for countries to have US dollar swap lines with the Federal Reserve during the crisis. The US Administration will not give up the geopolitical power implicit in the US dollar role easily.

It would make sense, but it will not happen, or at least not in my lifetime.