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A Few Thoughts on the Current International Monetary System

Remarks by
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The Bretton Woods System was born 70 years ago and broke down 44 years ago. 26 years of age is too young. However, the world has changed since then, enjoying economic and trade growth as well as financial market stability. The post-Bretton Woods era has enjoyed the benefits of a floating exchange rate system, but has also suffered chaos and panics. The world has seen the Mexican financial crisis, Asian financial crisis, the collapse of the dotcom bubble, and the recent 2008 financial crisis. We have also seen technological developments beyond what was originally dreamed possible, in areas such as mobile internet, automation, cloud computing, big data, and so on. Geopolitical power shifts, competition for world economic powers and natural disasters are changing the world every day. The current international monetary system, in general, bears a lot of unsatisfactory characteristics. Domestic currencies of major economies perform the roles of international money (medium of global transactions, store of international wealth, international unit of accounting), with each national authority (central bank) having responsibility over their domestic currencies, engaging in monetary management to achieve monetary policy objectives that are in the national interest. Little or no regard is paid to monetary and financial issues that are in the global interest. Indeed, no super-national currency in a meaningful form is dedicated to serving the global interest. For many years, we have had globalized financial markets everywhere, with generally open capital accounts and a free flow of capital across jurisdictions and currencies to achieve diversification of investment opportunities and funding sources. However, we have also seen that capital flows are volatile and voracious, particularly for small and medium-sized open economies (newly emerging enough to attract international capital and small enough to be tossed around). In 44 years, due to an absence of international standards, rules or regulations to guide or govern international monetary activities, incidences of monetary and financial instability occurred rather too frequently.

American economic dominance has led to monetary dominance of the US dollar in performing the functions of money on the international dimension, and dollar dominance generated privilege for the US in running large and sustained current account deficits and budget deficits. Due to the absence of a better choice, emerging markets continue to finance US deficits as protection of monetary and financial stability, and as safe haven assets even in times of global financial crisis.

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Though improving, US economic numbers are neither truly better nor more stable, in addition to monetization of budget deficits – normally a recipe for monetary and financial disaster in jurisdictions with no such privilege. Six years after the 2008 global financial crisis, the remaining financial market bubble that has not burst is likely the market for US treasury bonds and other G7 treasury bonds. What we are facing in the markets is an unstable equilibrium in the international monetary system with huge risks for the global economy. To these system weaknesses, we must do something quickly, even if they are still not very fundamental.

In this case, what we must do is to make most of current opportunities.

1. National monetary policies should be better coordinated.

Six years after the 2008 financial crisis, the US's Quantitative Easing (QE) policy is reversing. The market expects the US Federal Reserve to raise interest rates sometime in 2015. All else being the same, the reversed operation of QE and a US interest rate hike, if rushed or overshot, will highly likely act as a trigger, causing huge capital outflows across borders. The emerging economies that suffered from a huge dollar trap (accumulations of US dollar reserves) may once again suffer from sudden outflows of capital. As a result, several red flags have begun to appear. Eurozone bonds have fallen to 200 year lows and emerging markets are now particularly sensitive, with many red flags of uncertainty just as the Federal Reserve is about to complete its taper of QE. We all know that fiscal and monetary stimulus with lax regulations will stimulate false growth and asset bubbles, and we also know that once these themes slow or reverse, the consequences could be quite significant. In a world so deeply inter-connected, we have every strong reason for better coordination of national rules, policies and processes to be developed to help ensure stability.

2. Information sharing and disclosure should be improved.

The SDDS (Special Data Dissemination Standards) and GDDS (General Data Dissemination Standards) are good efforts by the International Monetary Fund (IMF) at institutionalizing data sharing. We are told that in an era of big data, about 90% of the world's data has been created in the last two years alone, and that 90% of this data is not well structured nor analyzed. There is still room for the IMF to do more to encourage data mining and sharing, as well as provide member countries with more meaningful information to facilitate monetary policy decision making. The most striking issues over the past 44 years have been that a) central bankers and heads of finance ministries in many countries have not had adequate mandates to share their data with others, and b) even if such a mandate exists, they are often not willing to share, particularly during times of economic distress. These highlight the fact that the IMF has to strengthen its powers of sanction and incentives for compliance to certain norms and standards, to monitor, assess and review so as to ensure that necessary, quality data is surrendered by member countries to help identify significant exchange rate instability and misalignments.

3. Capital movements should be carefully monitored and better managed.

Under the current international monetary system, the yield-driven behavior exhibited by investors is exacerbating cross-border inflows and outflows of capital, which will destabilize national and international financial markets. Hence, countries should sequentially liberalize their capital accounts in line with their efforts to strengthen their governance. The IMF should encourage relevant countries to adopt suitable policies, such as Tobin tax-like approaches, to sterilize the volatility of capital flows and ensure sustainability.

4. Cooperation and coordination should be at all levels.

International cooperation and coordination should be made a strong focus in the coming years. First, the IMF and FSB should work more closely to deal with stability issues. They should not only share data and analytical frameworks, but also human resources. Globally speaking, all nations should realize quickly that cooperation and coordination should be promoted and strengthened bilaterally and/or multilaterally, and this should be done thoroughly, substantively and in good time.

Why I stress this point is that this is a political process and we are sad to see quite often national interest considerations of the major stakeholders override the global interest. We do need a bold initiative that regains extraordinary political vision, wisdom and courage.

5. The role of a multi-currency system should be recognized in international trade and international payments.

Discussion and efforts should be provided to encourage the creation of an international reserve currency to become a widely accepted international payment and reserve instrument. And the desirable goal is to disconnect the currency from individual nations and is able to remain neutral and stable in the long term, thus removing the inherent deficiencies caused by using credit-based national currencies. Before that, the role of a multi-currency system should be recognized and subject to market needs, and the multi-currency system should be used more in international trade, investment and payments. Because natural competition plays vital role in driving us forward, a shift in economic power is unavoidable and respective currencies should play corresponding roles, as was the case in the 1940s. At the very least, such a move will, in part, supplement the current US dollar dominated system.

In conclusion, in a risky and dynamic world, returning to the Bretton Woods System, or idly sticking to the current system, would be unwise. Higher quality information, implementing standards and committing to sharing, better disclosure, fully-fledged cooperation and coordination in deeds, and a refined financial governance system are the realistic solutions for all of us today.

If we commit to working together now, through the strength of our combined efforts we may be able to create a more robust and flexible system that is capable of adapting to future changes. Conversely, the combined suspicions and panics of market actors may also result in amplified shocks and even greater challenges – an outcome that we must be ever vigilant for.