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SCENARIOS FOR THE FUTURE OF THE INTERNATIONAL MONETARY SYSTEM

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Abstract *The paper argues that at present the overhaul of the global economic and financial architecture evolves on four different, although interdependent tracks: re-basing the international monetary system; recognizing the role of emerging economies in global governance; reinforcement of the special drawing rights (SDRs); and the restoration of the gold standard. The paper puts forward three scenarios for the evolution of the international monetary system, including the Repair and Improve Scenario, the Multi-polar/Bipolar Scenario, and the Renewed Multilateralism Scenario, underscoring that the Multi-polar Scenario is seen as the most likely in the medium term.*

Key words:
International monetary system, international financial institutions, rising powers, scenarios

JEL Codes:
E52, F33, F53, F55

1. Introduction

The effective functioning of global business relies on a set of monetary, exchange rate mechanism and financial regulatory systems that stem from landmark decisions towards the end of the Second World War – often referred to as the *Bretton Woods Agreement*. The key mechanisms of the International Bank of Reconstruction and Development (IBRD) and the International Monetary Fund (IMF) originated from the United Nations Monetary and Financial Conference held in at Bretton Woods, New Hampshire, USA July 1-22, 1944, with the participation of 44 countries.

The global financial and economic crisis, the economic power shift from the U.S. and Europe towards the rising powers in Asia, and the setting up by the BRICS countries in 2014 of a new development bank have all reinforced the trend towards reconfiguration of the global financial and economic order. Viewed by some as a *new Bretton Woods*, this major overhaul of the global economic and financial architecture currently evolves on four different, although interdependent tracks which are explained below.

2. Re-basing the international monetary system

The first track would be to re-base the international monetary system on a dollar-renminbi-euro triad or, at least, in case of a deepening of the euro crisis, on dollar and renminbi (RMB), which is tantamount with a reversion to regionalism (World Economic Forum, 2012, pp. 18-19). Between 1995 and 2010 China's weight in the world economy has more than quadrupled. In the summer of 2010, the Chinese economy has surpassed Japan's economy, thus becoming the second largest economy of the world, as well as the largest exporter. By 2050, the nominal GDP of China (calculated at current exchange rates, which takes into account the level of inflation) could be almost 20 per cent larger than the U.S. or even twice as big as that of the U.S. (Pop, 2014, p. 26). Emerging powers argue that an international monetary system in which the dollar, the euro, and China's renminbi (RMB) or, alternatively, only the American and Chinese currencies share the reserve currency role would be an improvement over the current system where countries seeking to accumulate reserves have no alternative to accumulating dollars (Richburg, 2011) and the concentration of many functions of the international monetary system in one currency "may increase systemic vulnerability stemming from shocks or policy decisions in reserve currency issuers that would impact the rest of the world" (Maziad and Kang, 2012, p.3). The RMB's gradual internationalization surely works in the direction of this track. In the past, RMB could only be held inside China and all of China's internal trade was settled in RMB. China's currency can now be held and invested overseas. Trade of goods and services in and out of China can be settled in RMB. But a national unit is attractive as an international currency only if that unit is stable and markets in it are liquid. A move towards a liberalized capital account and more flexible exchange rate regime will be a major challenge for China, and meeting it requires much more than sheer economic size. However, according to a Bruegel analysis, somewhere around 2019-2022, China would be able to raise the status of the RMB over and above that of the yen or even possibly the British pound or Swiss franc. Moreover, by 2027-2033 the RMB could become a very serious challenger to the euro and by 2037-2042 it could overtake both the euro and the dollar as the predominant global currency (Vallée, 2012, pp.1, 33-34).

3. Recognizing the role of the emerging economies in global governance

The second track of establishing a new Bretton Woods would be to rightly match the emerging and developing countries' weight in the global economy with their power and influence in setting the rules and institutional arrangements of the world economy. Emerging powers deem that major governance reforms are needed, translating in particular to changes in quotas, voting rights, executive board representation and transparency in the management selection process. Although the IMF, the World Bank, and the World Trade Organization (WTO) have taken important steps to increase representation to reflect the shift in economic power toward developing countries, many rising powers remain unsatisfied. Institutions such as the Bank for International Settlements (BIS) and International Accounting Standards Board (IASB) are behind the curve in giving adequate representation to China, India, Brazil and other rising powers. Additionally, further reforms are needed at the level of the IMF, World Bank and G20 (Draper and Dube, 2010, pp.3-4). These include a further redistribution of quotas in the IMF to reflect changes in the global political economy while maintaining the quota shares of over-represented developing country members; a more equitable representation of developing countries on the IMF Executive Board by merging some European seats into a single Eurozone seat; a reconfiguration of the selection procedures of the head and staff positions at the IMF and World Bank as to allow appointments to such positions through an open, transparent and merit-based process; a further improvement of representation of developing countries in the G20; and a possible relocation to Asia of, at least, the secretariats of some of the Basel-based committees (Menkhoff and Meyer, 2010).

4. Reinforcement of the Special Drawing Rights

The third track is focused on the reinforcement of the Special Drawing Rights (SDRs) by enlarging the *basket of currencies* on which it is based to all major economies. Just prior to the G20 London summit on 2 April 2009 the Governor of People's Bank of China proposed the first tentative plan for replacing the US dollar's role as the world reserve currency (Pettis, 2009, p. 3). He suggested extending the "basket of currencies forming the basis of SDR valuation to all major economies and set up a settlement system between SDRs and other currencies so they could be used in international trade and financial transactions" (Anderlini, 2009). There is one major inconvenience with this proposal and it refers to the fact that the new SDR would be distributed in accordance with the current quota-shares of the IMF member states. Consequently, the developing and transition economies, which badly need liquidity support from the IMF, would get less than 37 per cent, and the low-income countries less than 8 per cent, while the G7 countries, which do not need liquidity support, would get over 45 per cent. Therefore, any reform of the international monetary and financial system geared at making the SDRs a global reserve medium would have to address the issues of SDRs allocation (UNCTAD 2009, pp. 121, 123-124) and creating the critical mass for the SDRs to become a world reserve currency. Moreover, in order to create the critical mass for the SDRs to become a world reserve currency, some 3,000 billion SDRs would be needed. A solution, which was first discussed in the late 1970s, would be to create a *substitution account* at the IMF denominated in SDRs as to create the possibility for central banks to convert their dollars in SDRs. A more practical approach would be to include in the current basket of currencies both the BRICS country currencies, but also those currencies that reflect the evolution of the aluminium, iron, gold or crude oil (Reisen, 2009). This means including the currencies of countries such as Australia, Canada, Chile, and Norway, thus linking the SDRs with the cycles of these key commodities.

The process of reinforcing the SDRs has been gradually but steadily developed starting with the IMF decision of July 2009 to allow the issuing of securities denominated in SDRs to draw in resources from some emerging economies (Brazil, China and Russia), and continuing with the G20 decisions at its Washington summit in April 2011 to work on a "criteria-based path to broaden the composition of the SDR", and the G20 decisions at its Cannes summit in November 2011 to review the SDRs' basket of currencies in 2015. In light of fact that starting the 1st of October 2016 RMB is the fifth currency in the SDRs' basket of currencies, the notion of the SDRs playing in future the role of a global reserve asset or a de facto world currency seems more plausible than some years ago (Grevi, 2011, p. 4).

5. Restoration of the gold standard

The fourth track of establishing a new Bretton Woods would be a restoration of the gold standard (O'Driscoll, Jr. 2012). The New York Federal Reserve acts as the custodian of the gold owned by 122 account holders which include the U.S. government, more than 60 foreign governments, other central banks, and a few of international organizations including the IMF. According to the New York Fed's estimations, approximately 98 percent of the gold bars stored in its Lower Manhattan vaults belong to central banks of foreign countries. Much of the gold bullion arrived during and after the Second World War as many countries wanted to have a place of safe-keeping for their gold reserves. The volume of the gold stored continued to expand and climaxed in 1973, immediately after the U.S. suspended convertibility of dollars into gold for foreign governments.

The UK was a role model for the gradual adoption by other countries of the gold standard in the 19th century. Hence, a resumption of the gold standard could come about through the impetus given by a powerful actor on the international stage rather than through international agreement (White, 2012). The impressive accumulation of gold reserves by Russia and China throughout the current financial and economic crisis – as well as the diversification of the IMF's revenues through the creation of a fund supplied with gains from the sale of gold – both surely work in that direction (Kaya, 2012).

6. Scenarios for the evolution of the international monetary system

Three scenarios could be outlined for the evolution of the international monetary system:

- The *Repair and Improve Scenario* assumes the continuation of the on-going policy efforts to improve the functioning of the current system organised around the U.S. dollar through incremental reforms.
- The *Multi-polar/Bipolar Scenario* envisages that the U.S. dollar remains the main international currency but other currencies also play a role in the international monetary system as reserve currencies, anchor currencies and on international markets for goods and assets. Among the latter one would include the euro and the RMB (or only the RMB), as well as a possible single currency of North America, East Asia (or East Asia plus Australia, New Zealand and India) or a BRICS currency.
- The *Renewed Multilateralism Scenario* posits renewed, possibly crisis-led, steps towards building a multilateral international monetary order. Since neither the RMB nor the euro emerge as major international currencies, the need for diversifying official and private reserves is met by the emergence of the SDRs as a widely used quasi-currency.

7. Conclusions

Taking into consideration the current four main tracks at reconfiguration of the global financial and economic order, i.e. re-basing the international monetary system, recognizing the role of emerging economies in global governance, the reinforcement of the Special Drawing Rights (SDRs), and the restoration of the gold standard, this paper has put forward three scenarios for the evolution of the international monetary system, including the Repair and Improve Scenario, the Multi-polar/Bipolar Scenario, and the Renewed Multilateralism Scenario. Although all three scenarios would offer improvements compared to the current system, the Multi-polar/Bipolar Scenario would best correspond to structural changes in the world economy and mitigate some of the imperfections of the current system (Angeloni, Bénassy-Quéré *et al*. 2 011, pp.2-3, 56-77). The Multi-polar scenario is seen as the most likely in the medium term. This is confirmed by early estimates of the U.S. National Intelligence Council at the beginning of global financial crisis (NIC 2008, p.11-12, 94), as well as by more recent assessments which speak about the likelihood of an uneven multiple international currency system (Chey, 2012).

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