Introduction

❖ Global Financial & Monetary Order Transition
❖ Bretton Woods Order
❖ Globalization of Financial Markets
❖ Collapse of the Gold Standard, Rise of the Dollar
❖ Shift to a Floating Exchange Rate System
❖ Conclusion

Tomohiko Shibata
Transition of globally integrated financial and monetary order - from 1910s to 1930s -

• Pre 1914
  • Gold standard – fixed exchange rate regime
  • Some European countries created ‘monetary unions’ and imperial currency blocs

• The wartime of WW1
  • Many countries abandoned the gold standards

• After the WW1
  • Restore the pre 1914 international monetary and financial order, the gold standards

• 1930s financial crisis, Great Depression
  • Collapse of international gold standard and international lendings
  • Closed currency blocs -> floating exchange rate

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Hegemonic Stability Theory

• Pre 1914
  • British had hegemonic leadership on stabilizing the international financial and monetary regime
  • UK currency was “as good as gold”

• After WW1
  • US replaced UK as the lead creditor
  • US dollar became the strongest and most trustworthy world currency
  • US’s isolationist sentiments and domestic political conflicts -> breakdown of the pre 1914 order

The absence of a state acting as a hegemonic leader to perform the roles: the provision of stable international lending, the maintenance of an open market for foreign goods, and the stabilization of financial markets

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Domestic Political Conditions

• Pre 1914
  • Governments are less responsive to domestic popular pressures

• After WW1
  • The domestic political order was transformed in many independent states
  • Political pressures should be geared more towards domestic goals

• Financial crisis in 1930s
  • Many governments chose to abandon the international gold standards -> floating exchange rate

Domestic political transformation across much of the world associated with expansion of the electoral franchise, the growing power of labor, and the new prominence of supporters of interventionist economic policies
Creation of The Bretton Woods Order

- After the war in the early 1940s, US officials were determined to play a leadership role in building a more liberal and multilateral international economic order.
- “embedded liberal”---The original idea was from John G. Ruggie(1982)
- With the move of the US officials and policymakers, In July 1944, 44 countries endorsed a final set of agreements to this order at a conference in Bretton Woods.
A different kind of Gold Standard
(Four Major Features Under New Agreement)

● A gold exchange standard (at a rate of $35 per ounce)
● Currency convertibility for current account payments & Capital Controls
● An adjustable peg exchange rate regime
● The IMF and World bank
The IMF and World Bank

- The IBRD or World Bank— to promote general economic development.
- It was designed to encourage long-term loans for reconstruction and development after the war.
- The IMF— to maintain order in the international monetary system through a combination of discipline and flexibility.
- It encouraged countries to shorten the duration and lessen the disequilibrium.
Problems and Heyday of the Bretton Woods System

- Soviet Union and its allies withdrew the system after the Cold War, and People’s Republic of China withdrew the system also after the Chinese revolution in 1949.

- This agreement was supposed to give each country an opportunity to exchange the currencies in a fair way, but it turned out that many countries did not make their currencies convertible for the first decade-and-a-half after the Second World War, until 1958.

- During this period, although the Bretton Woods order was sidelined, other bodies such as US government and European Payment Union acted in the ways that the Bretton Woods architects had hoped the IMF and IBRD would.

- This order reached its heyday between 1958 and 1971.
Consequences

Accomplishments:
  The IMF and World Bank still exist, most currencies are convertible for current account transaction, and multilateralism has endured.

Challenges:
  The globalization of finance, collapse of the gold exchange standard, and the move to a floating exchange rate regime among the major economic powers.
The Globalization of Financial Markets

I. How did we get today’s financial environment

II. Implication for national policy autonomy

III. Distributive and environmental implication of financial globalization

Risa Tanaka
I. How did we get today’s financial environment

1. Technological development

   *telecommunication made it easier for people to move the money globally. This encouraged people to diversify their assets.

2. Governments’ support

   1960s: The British government encouraged the growth of the “euro-market” in London during

   early 1970s: Many governments then fully dismantled capital controls they had employed at various times during the post war years

   1974: The US /1979: The UK abolished their national capital controls

Risa Tanaka
I. How did we get today’s financial environment

Efforts to codify a more liberal set of international rules

1988: European Union directive to liberalize capital controls

MID1990s: A more ambitious initiative Bretton Woods rules

Abandoned 1997-8: the East Asian financial crisis
II. Implication for national policy autonomy

- financial globalization has severely undermined national policy autonomy
- Southern governments are seen to be especially vulnerable

1980s: The international debt crisis

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Ⅲ. Distributive and environmental implication of financial globalization

- **Class**: Mobile capitalist class
- **Sectoral**: Transnational corporations / owners of financial assets and services
- **Gender**: Women’s low power
- **Environment**: Distraction of natural forests

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The collapse of gold exchange

- The Bretton Woods’ gold exchange standard broke down when Richard Nixon suspended the convertibility of the US dollar into gold in 1971.
- Since other currencies had been tied to gold only via the US dollar, this Nixon shock signaled the end of gold’s role as a standard for other currencies.
- By the late 1960s, the United States was doing much more than providing the world needed international liquidity; it was exporting inflation by flooding the world with dollars.
- In 1971, when speculative pressures against the dollar reached a peak, the United States chose simply to ‘close the gold window’ in order to free itself from the constraint on its policies that gold convertibility imposed.
The dollar’s enduring global role

- The US dollar’s enduring central global position is a partly a product of the enormous size and significance of the US economy in the world.
- Some foreign governments have continued to hold their reserves in US dollars and denominated their international trade in dollars because of economic and political ties with the US.
- The dollar’s global role has been enduring because the US financial markets have remained the most liquid in the world because of their depth, breadth, resilience, and openness to foreigners.
Consequences of dollar’s declining role

- In addition to the international prestige that comes from issuing a dominant world currency, the US dollar’s use abroad has produced extra seigniorage revenue for the US government.
- The dollar’s global role has also bolstered the US capacity to finance current account deficits as well as to deflect the costs of adjustments by depreciating its currency.
- The US authorities have been able to use the dependence of market actors on dollar-clearing networks to encourage worldwide cooperation with US regulatory initiatives as well as to enforce sanctions against foreign states.
- As the sole producer of the world’s key currency, the US also plays a decisive role during international financial crises.

Yuna Goto
The US might also feel less of a burden of responsibility to maintain the stability of the international monetary system as a whole.

The US would also be less vulnerable to the selling of external dollar holdings as well as the overvaluation of its currency that can result from foreign demand for the dollar.

It has enabled their country to live recklessly beyond its means and had encouraged a pattern of US growth characterized by large current account deficits, foreign capital in lows, and accumulating foreign debt.
Key Points

- In 1971, the United States ended the gold convertibility on its currency, and, by extension, that all other currencies. The US decision reflected its desire to free itself from the growing constraint on its policies that gold convertibility was imposing.
- The US dollar continued to be a dominant global currency after it ceased to be convertible into gold in 1971 for a variety of economic and political reasons.
- The US dollar’s global role may face new challenges over time, challenges that would have important implications for the US and international monetary system as a whole.
From Adjustable Pegs to Floating Exchange Rates

- In the 1970s the adjustable pegs system broke down partially due to the growing size of the speculative international financial flows that complicated government's efforts to defend their currency pegs.
- Also, influential policy makers began to re-evaluate the merits of floating exchange rates, a type of exchange rate that depends on the market forces of demand and supply.
- This led to governments to allow world's major currencies to float in value vis-a-vis one other and was formalized finally in 1978 after it was amended by the IMF.
- While the floating exchange rates have performed an important role in facilitating balance-of-payments adjustments, critics have argued that they have been subject to short term volatility and longer-term misalignments.

Lee Jaesung
From Plaza to Louvre

- Increased US current account deficit caused by speculative financial flows caused protectionist sentiment to spread within the United States.
- This caused the US and the other G5 nations to consider briefly a move back towards more managed exchange rates. This led to the Plaza Agreement in September 1985, which committed these countries to work together for dollar depreciation against major trading currencies.
- After the dollar had fallen 50% vis a vis the yen and the german currency, they announced the Louvre Accord which established target ranges for the major currencies to be reached.
- Result: Failed because Germany and Japan argued US were only interested in reducing own external deficits through policy amendments in foreign states and asked Japan and Germany to revalue their currencies.

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Arguments between leading powers such as the one that took place after the Louvre agreement had most recently occurred in the context of the growth of East Asian trade surpluses since 2000. Particularly, China, have undervalued their currency for competitive advantage undermining the IMF rule that prevents exchange rates to be manipulated for their own advantage.
Bretton Woods II cont.

- The core of Bretton Woods II
  East Asia: supported export-oriented industrialization strategies
  US: wanted to gain cheap imports, and low cost foreign funding
- The US has asked for trade agreements to include provision outlawing currency manipulation
- Result: TPP in 2015 included to refrain from manipulation but not legally binding

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The G20 Mutual Assessment Process

- Concerns regarding disharmonious macroeconomic coordination on global imbalances led to the creation of new G20 forum in Nov. 2008
- The first two summits focused on international regulatory issues designed to minimize future crises (2008)
- In the third summit, countries agreed that G20 was now the premier forum of international economic cooperation and committed to a ‘Framework for Strong, Sustainable and Balanced Growth”
- Supported by IMF and World Bank
- Many hope that the new G20 mutual assessment will reinvigorate the multilateral exchanges rate management and coordination such as the Plaza Loure Period.
- Political challenges lay ahead as the global society is less hegemonic than post-war.

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The Creation of the Euro

- Countries in the EC attempted to stabilize exchange rates among themselves: led to the EMS. European Monetary System
- The Euro was created mainly so that none of the member nations would try to manipulate the currency to meet anyone’s needs.
- Other benefits include: greater price and wage flexibility, social protection, promotion of equity, growth and employment, euro becoming a way to lower domestic interest rates and challenge the role of the dollar in the global stage.

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Crisis of the Euro

- Absence of clear rules for solving financial crisis in the eurozone
- No provision of adequate adjustments for interzone payment
- Difficult for large scale labor migration
- No Europe-wide authority and unity (12 different voices perhaps?)
- Small nations argued that many of the policies were tilted in the favor of large nations.

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Currency Unions

- Examples of Currency Unions:

  CFA (Communaute Financiere Africaine)
  ASEAN + 3 (China, Japan South Korea)
  Dollarization in Ecuador and El Salvador
Conclusion

Globally Integrated Order

Liberal International Economic Order (Bretton Woods Order)

Globalization of Finance/Collapse of Gold Exchange Standard

Floating Exchange Rate System
Discussion Questions

- Which do you think better explains the reason for the collapse of pre 1914 system: the Hegemonic stability theory or the domestic political conditions?

- Are the euro and the renminbi capable of challenging the dollar’s position in the future?

- Would Bitcoin and other Cryptocurrencies bring positive/negative influences to the financial system?

- What would happen if the Virtual currency was in the place of global fiat currency?

- How will Brexit affect the Euro Currency?