

III. DEZVOLTAREA DURABILĂ – DE LA TEORIE LA PRACTICĂ

RESHAPING THE WORLD FINANCIAL SYSTEM – AN IMPERATIVE OF SUSTAINABLE DEVELOPMENT

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Abstract

This paper presents the general and specific causes which led to the actual financial and economic crisis, the principal consequences of this crisis like some other theoretical considerations regarding the cyclical normal evolution of the economies and the major disequilibrium instauration between the market's components which generates crisis. A critical analysis of the actual financial and monetary system emphasizes its pro-cyclic character. On the following pages, the weaknesses and vulnerabilities of the present system are put into light, starting with: lack of an international reserve currency to ensure stability and development, use of complex and opaque financial instruments, making decisions taking into account the rating agencies statistics which have serious problems especially in operating actions, unsecured procedures for the financial assets' evaluation, existence of the so called "fiscal havens", inefficiency of "the market's invisible hand and aspects related to the current issues and sustainable development. Furthermore, the paper underlines the context of change and reform initiatives, governments' concerns for re-building the financial and monetary actual system and, finally, action lines and intervention to change completely the system and introduce a new international reserve currency. The need of change, key word for the prevention of future crises and necessity in the context of sustainable development represents the basic conclusion of this work.

Key-words: *financial and monetary system, international reserve currency, pro-cyclic phenomenon, sustainable development, the single currency*

JEL Classification: G01, G42, F33

1. A system that generates instability, polarity, crisis and inequity

The worse crisis after World War II, which started in 2007¹ spread very fast across the globe and its effects are suffered by the whole planet. The regional crisis affected, step by step, the entire economical and financial space in the world. The financial and monetary system itself was engulfed by the crisis and its weaknesses were demonstrated. As a result of this, a local crisis became a global systemic crisis. Thousands of billions of dollars and euros were necessary to save the system and to avoid a planetary catastrophe. And together with the system were also saved many of the techniques and procedures existing inside the system and many of the financial entities that caused the unprecedented crisis.

¹ The american ipotecary crisis, known under the name of sub-prime crisis.

Among the fundamentals that caused the crisis we mention:

- ✓ The neoliberal doctrine and the market economy based on this, which bears inside itself the germs of crisis.
- ✓ Excessive permissivity, de-reglementation, lack of civil or state control and new economic order based on globalization, non-ethics, which permitted the development (during the last 50 years), inside an almost anarchic regime, of the wild capitalism.
- ✓ Undervaluation of risks and transfer of those risks through sophisticated financial instruments which were proven “toxic”.
- ✓ Lack or poor performance of the self-regulatory systems of the international monetary and financial system which made possible the sub-prime crisis and its global propagation.
- ✓ FED’s expansionary policy.
- ✓ Lack of an international reserve currency un-anchored to a national currency and the growth of the interest rates as elements that caused the crisis.

The most important consequences of this crisis manifested and are continuing to manifest at national and global level (table 1).

Table 1

The most important consequences of this crisis

Global consequences		National consequences	
Financial	Economic	Financial	Economic and social
Liquidity crisis	Recession	For companies	Drop in consume
Credit rationalization	Drop in demand	For the state	Rising unemployment
Rising budget deficit	Insolvency	Increasing lack of credibility of the financial system	Sector crisis
Growing public debt as ratio of GDP	Globalization of the crisis	Market frictions	Structural crisis
Changing the current financial system	Economic policy to counteract the crisis	Adjustments	Destabilization of the financial and economic system

The normal evolution of the economies, figure 1, respective of the global economy (line 1) represents the fluctuations on a rising trend like in a tunnel marked by lines 3. The line 2 represents the periods of major rupture of the equilibrium among the components of economies and represents the crisis periods.

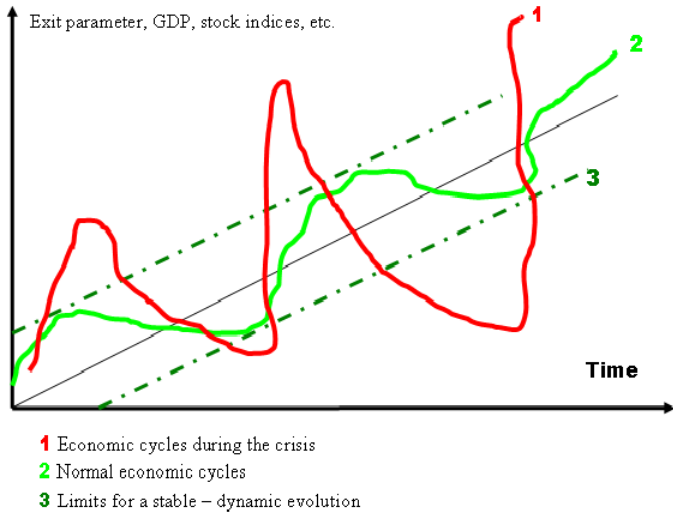
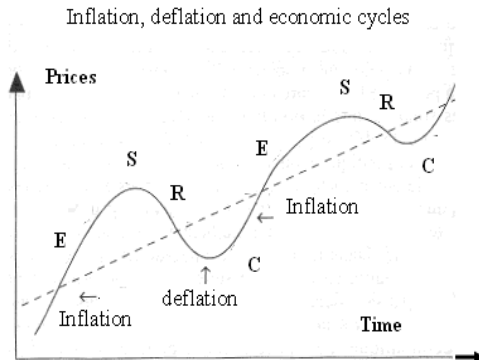


Fig. 1. *The normal evolution of the economies and the crisis periods*

The economic cycles evolve simultaneous with inflation and deflation. As we can observe in Fig. 2 the periods of economic expansion E are characterized by inflation and the periods of recession by deflation. The point S represents the changing of tendency E-R and the C point represents the continuation of economic growth after the minimum point of the period was already reached. As we can observe the general trend is ascending over time. As long as the components of the system are in a dynamic equilibrium, inside this tunnel, the economy is in a state of normality. The breaking of this equilibrium leads to crisis.



- E – expansionary period and rising inflation
- R – recession and deflation
- S – the point of changing the E-R tendency
- C – starting point of the new cycle of economic expansion, after the minimum point of the period was already reached

Fig. 2. *The economic cycles, inflation and deflation*

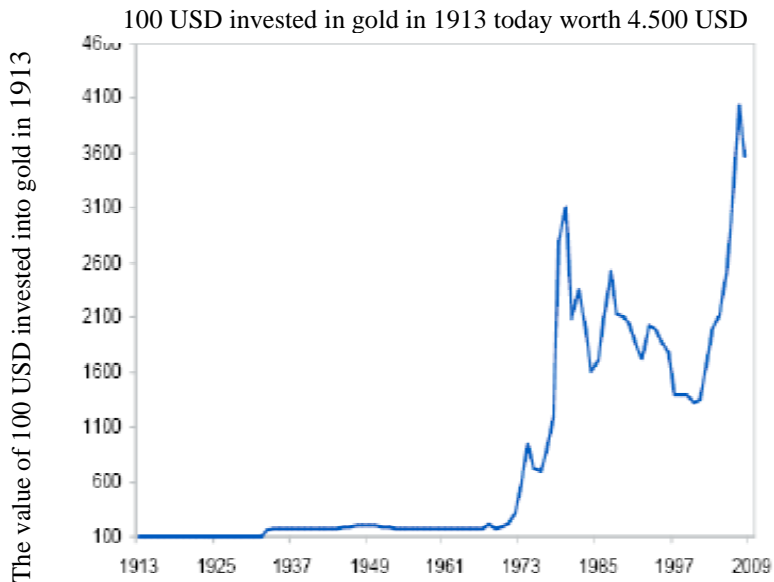
A critical analysis of the current financial and monetary system puts into evidences the deficiencies and weaknesses that we mentioned previously:

- A strong and manifest pro-cyclical character² which leads to periodic major imbalances between the market components and to manifestation of crisis Fig. 1 curve 2.
- Lack of an international reserve currency to ensure global financial stability and facilitate economic growth worldwide. The origins of the current crisis are monetary in nature. Thus one can say that the current international monetary disorder is driven largely by using the standard dollar, fig. 3 and fig. 4, which became the standard currency etalon and replaced the system related to the use of gold. In the context of the economic crisis caused by U.S. and, therefore, its sharp depreciation, the dollar has led to the erosion of international reserves of countries that have such large USD holdings. Therefore, first China, the largest holder of dollar reserves, and then the countries identified by the initials BRIC, Brazil, Russia, India and China, and also UN demand more strongly, that the dollar be replaced in the role of money for international reserves. Besides, China is advancing the idea that DST³, the currency used by the International Monetary Fund, could be the currency able to ensure the stability of the new system, at least in an initial transition period, until the eventual establishing a new international currency that could be the basis for a new international financial system that is expected to be realized. Zhou Xiaochuan, governor of the People's Bank of China, said that the purpose of the proposal to replace the dollar as international reserve currency with a new global system controlled by the International Monetary Fund is to create a reserve currency "unplugged individual nations and that can remain stable on long-term, thereby removing the deficiencies created by the use of currencies based on monetary emission⁴". Russia criticized increasingly more the international monetary system dominated by U.S. dollars and launched strongly the idea of using more the ruble which should reach the status of the dollar.
- Possibility of using new global financial instruments increasingly complex, sophisticated and transparent.
- Basing decisions on ratings given by rating agencies, few in number, and operating without any control by civic or governmental nature on their work. When the crisis appeared it highlighted the major deficiencies of the rating agencies.

² <http://www.consilium.europa.eu/App/NewsRoom/related.aspx?bid=93&grp=15487&lang=EN&cmsId=339> COUNCIL OF THE EUROPEAN UNION, Council conclusions on procyclicality 2954th ECONOMIC and FINANCIAL AFFAIRS Brussels, 7 July 2009, Procyclicality is the term used for the exaggerated fluctuations witnessed by the markets.

³ At present, the value of a DST is compounded by a basket of currencies – usd, yen, euro and sterling.

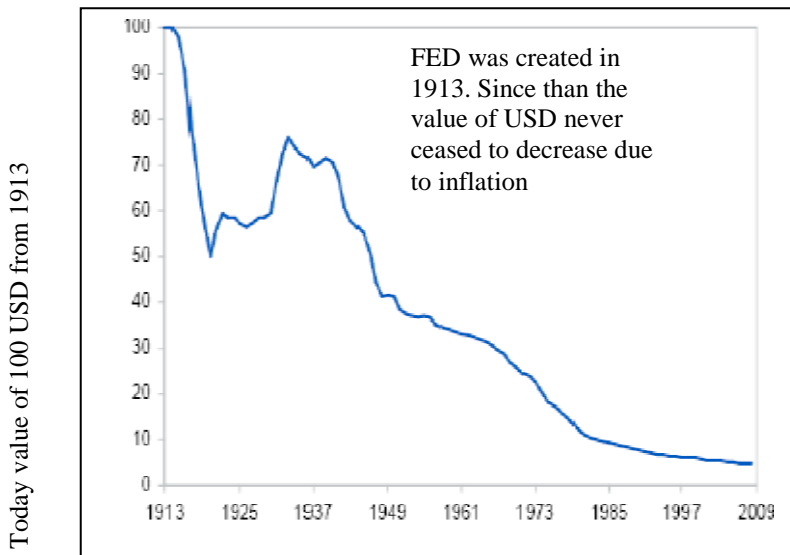
⁴ Financial Times, Mar 24 2009, Jamil Anderlini in Beijing, China urges switch from dollar as reserve currency.



Source: Bloomberg, University of Michigan, Schroders. October 2008/Lyxor. December 2008

Fig. 3. *The value of 100 USD invested into gold in 1913*

100 USD from 1913 today worth less than 5 USD



Source: Bloomberg, University of Michigan, Schroders. October 2008/Lyxor. December 2008

Fig. 4. *Today's value of 100 USD from 1913*

- The existence of conflicts of interest between rating agencies and entities evaluated.
- Valuating and scoring procedures at least questionable and sometimes arbitrary. For the innovative, complex and usually without transparency financial instruments, evaluation and grading procedures are developed in small circles and then they are provided without a critical analysis and especially without any control.
- The existence and tolerance of non-transparent tax havens.

The main lesson of the current crisis is that financial markets are not able to establish fair prices. This led to the realization of the fact that the current financial system, generating greater inequalities, failures, imbalances and biases, must be fundamentally reformed.

It was thus demonstrated that “invisible hand of the market” alone cannot bring order in the market. We need also responsibility, civic or governmental control and ethics.

By not reforming the system and limit only to save it at the cost of injection of trillions of dollars and euro could have, over several other years, as a consequence, a new crisis much stronger and with truly devastating effects.

Sustainable development cannot be achieved using the current international financial system because its weaknesses and vulnerabilities mentioned above clearly contradict with the principles of sustainable development. Thus, principle 85 which states that “in order to achieve sustainable development and a better quality of life for all people, the states should reduce and eliminate unsustainable models of production and consumption [...]” and the current financial system proved to be unsustainable. For that is generating major imbalances – crises of all sorts – is at the base of the development of wild capitalism, unethical globalization and produces a immoral high polarization of the world that is a potential carrier of a conflictive potential that sooner or later will be manifested. The current financial system comes into contradiction with the 12th principle of sustainable development: “States should cooperate to promote an open international economic system conducive to economic growth and sustainable development in all countries, in order to better address issues of degradation of the environment. Trade policy measures for environmental purposes should not constitute means of arbitrary or unjustifiable discrimination or any kind of disguised restraint on international trade. [...]”

As seen, the current financial system cannot ensure long term stability and, instead of leading to growth and sustainable development, they lead to crises, recession, extreme rich-poor polarization and environmental destruction thus coming into conflict with future generations. If we also mention the financing of the economy, meaning breaking the correlation of the financial system from the real economy, where speculation comes first, the rethinking of a new international monetary-financial system becomes imperative.

2. Context change

The idea that dollar is no longer a good reserve currency, safe and able to offer stability, is not something new. The “need” of a new global single currency “bancor” was expressed by JM Keynes and that of the “unitas” by FD Roosevelt. Recently, a Nobel laureate, Joseph Stiglitz, expressed his preference for a new reference currency, other than the dollar, since the dollar poses a high degree of risk.

The consequences of many of the actions of the financial gods of Wall Street, which are *de facto* responsible for the crisis that has reached across the globe, are examined and criticized by more countries. And obviously people are looking for those responsible. Thus the Kremlin often criticized the global currency status of the dollar. Also Russia has seriously diminished its dollar reserves and the Russian President Dimitry Medvedev and the Prime Minister Vladimir Putin have repeatedly tried to promote the use of ruble as a reserve currency, even for regional use. China, given the significant investments it has made in U.S. government securities, fearing that it will depreciate because of major recession and the U.S. budget deficit amid the global crisis, has asked and continues to seek the introduction of new currencies. Against this background, the republican Michele Bachmann introduced a law in the House of Representatives which prohibits replacing the dollar with any other foreign currency. In response to the request of the Chinese government.

The Finance Ministers from Saudi Arabia, Bahrain, UAE, Kuwait, Oman and Qatar signed an agreement establishing a single currency and a currency board which would become the Gulf Central Bank, currency that would be launched no later than 2010.

Secretary of the Treasury and Federal Reserve chief, Ben Bernanke, have rejected the idea of creating a single global currency, but even if they returned and nuanced, the U.S. Treasury Secretary Tim Geithner, has caused a real earthquake in global markets, saying that Washington is “pretty open” to China’s proposal for gradual implementation of a global reserve currency, under the coordination and management of the International Monetary Fund.

„Replacing the dollar in favor of a system based on the SDR will be a major break with a policy determined now more than 60 years,” says in an open letter Onno de Beaufort Wijnholds and Detlef Kotte said in an interview quoted by The Telegraph that “replacing the dollar with an artificial currency would solve some problems related to the accumulation of huge deficits and would stabilize the situation”.

Russia calls the foundation of a new global currency to replace the dollar and China is considering a currency basket of currencies extended by including all the major economies of the world and establishing a system of rating between the SDRs and other currencies, so that the SDR can be used as currency reference to financial transactions and international trade.

The Kazakh President proposes, as a solution to the current financial crisis the “acmetal”, the single world currency.

Another Nobel laureate, Robert Mundell, father of the European single currency “euro”, was in favor of the proposal made by the President of Kazakhstan, Nursultan Nazarbayev, to introduce the single world currency, “acmetal”, saying that the plan of introducing such currencies is feasible and that it offers very good prospects for the world economy. Mundell proposed that Asia should also create a single currency having U.S. dollar as anchor and also said he was in favor of the need to create a global single currency with fixed rates against the currencies of the most developed economies: the U.S. dollar, the single European currency and Japanese yen.

There is information published by the “The Independent” newspaper, according to which several Middle East states are in talks with Chinese officials, Russian, Japanese and French to withdraw from trading oil in U.S. dollars.

Since 2007, inside the United States is circulating a theory according to which the global economic crisis will lead to a major geopolitical restructuring: the formation of the North American Union (UNA), as a replica of the European Union. UNA would include the U.S., Canada and Mexico and will have “Amero” as the single currency. The dollar will no longer be necessary because it will depreciate until extinction. This scenario started from an event occurred on March 13, 2007. At that moment, the U.S. Senate held its fifth secret and informal meeting (in its 182-year history), the agenda appears to have been the following: the imminent collapse of U.S. economy, declining public finances and the imminent triggering of a civil war caused by the economic collapse. UNA would be provided with cheap labor from Mexico, raw materials from Canada, the currency would be the “Amero” and the dollar would remain without coverage and will be waived off.

Japan and Asian Development Bank together support the establishment of a common currency ACU (Asian currency unit), equivalent to the ECU (European currency unit), the ancestor of the euro.

3. Courses of action to reform the current monetary-financial system

From all the above we can see the preoccupation to reform the current financial and monetary system and the urgent need to achieve this goal. Unfortunately because of the need to save the system, the curative effects of any crisis, which is manifested by brutal and necessary bankruptcy of the non-performing entities which violate the market rules, were not allowed to manifest. And the role of crisis to clean up the market was taken over by the global management, and we refer here to the G20 made by transforming the G8, towards the interventionist regulatory way and by the way of introducing a necessary and appropriate control. That is, a “peaceful revolution” of the system will be difficult. For that, once saved, the entities responsible for the production crisis regain their power and influence will oppose hard changes that threaten their privileges. An example is the opposition to the taxation of financial transactions and the refusal of the proposal to limit bonuses received by bank’s managers.

Proposed since JM Keynes, the introduction of financial capital charges in order to reduce speculation and the creation of a world currency and a supranational management institution could have prevented such a major crisis or at least it could have lessen the effects. Moreover, the need for a new international reserve currency, a separate national currency is still very necessary and one of the courses of action to achieve the new system. Also, with all the major difficulties raised, some of them of technical nature, we still think that the taxation on financial transactions and the establishment from that charges of a fund of international solidarity with poor countries, or at least implementing the Tobin tax, is also an important direction for action.

As the crisis is not considered a circumstantial, lack of adequate control and the deficiencies of the rating agencies have been superimposed on top level relating to the structure and functioning mechanisms of the current monetary and financial system that are the root causes of the current crisis. Of which we mention the dominant role of the U.S. dollar as international reserve currency, and the huge deficits that it is based upon and the creation of money and injecting it into the market through sophisticated and non-transparent instruments, bright and packed, disseminated with the support of some big names of banks. Therefore, there is necessary a severe legislation in both the financial and the banking circuits.

A very important direction of action is to strengthen the banking and financial regulations and to rethink the functioning of credit rating agencies: binding the creation of risk provisions to the loans, non-acceptance of security (financial instruments) off balance, refusing refinancing by the central banks to the banks that hold securities with speculative proposes, the solvency ratio increased to $\geq 8\%$ of the risks undertaken, the development of regulations to eliminate the black holes of derivatives markets, hedge funds, including the OTC market. Evaluation of financial return for investors and traders, in order to reduce the speculative hedge spiral and to diminish the financial arrangements, perhaps even the certification of the titles introduced in the market by an independent authority. Also requires a rethinking of rating agencies by diversifying and increasing their numbers and their evaluation and approval by an independent authority. Also there should be developed uniform criteria for risk assessment by rating agencies.

Another direction is to increase the role of global governance in order to increase the role of the IMF and the restructuring and modernizing them with increased financial resources and providing new powers in particular as regards market surveillance. We can say that the crisis has brought again the state on the economic scene, which so far was dominated by the neo-liberal doctrine and the minimalist state, almost nonexistent.

Finally, the return of the financial economy to the real economy and providing it with the necessary funds for healthy and sustainable productive activities that produce goods and services for the man who, under new management models, should be seen anthropocentric, that puts man in the center of all activities of technical, economic and financial nature.

Let us not forget two of the judgments of the European Council from 18-19 June, which "has agreed on a new supervisory structure to be introduced at

European level, inspired by the work of a group chaired by Jacques de Larosière.” The new framework aims to strengthen the supervisory system and restore confidence in the financial system, affected by global financial crisis. It involves the creation of a European Committee for the valuation of the global systemic risks and three supervisory authorities respectively banking, insurance and the securities, which to cooperate with the national authorities in a organized network. “The Council welcomes the GLPC report, which focuses on four main policy responses to reduce the potential pro-cyclical effects of financial regulation and the development of anti-cyclical measures, namely: 1) monitoring risk throughout the system, 2) creation of cyclical reserves through the provision of capital, 3) improving accounting standards and 4) establishing a solid framework for pay systems. The report focuses on developing a macro prudential approach through various means, including the inclusion of automatic stabilizers in the regulatory framework and through better information on the discretionary surveillance measures and amendments to the framework through enhanced monitoring regulations.”

4. Conclusions

1. The current financial and monetary system cannot provide exactly what such a system is meant to ensure, stability and development, and therefore should be mandatory to change it to the ground. Otherwise another crisis with effects far greater and more disastrous will happen. The question is not if but when will happen will happen.

2. It is necessary to create reserve currency that is not a national currency, to avoid future conflicts between internal and external interests that a currency issued by a central national bank usually involves and thus bears the seeds of vulnerability of any financial and monetary system based on such currency. The U.S. dollar has exhausted all possibilities for founding an international financial and monetary system.

3. We consider that a new currency would be based on a commodity-type anchor and a basket of currencies weighted to represent the world economies. For reasons of political acceptability type, in this basket there should be placed all the national currencies. Such a global single currency could be denominated monemo, monem or other similar names, in order to suggest the global nature of it.

4. It is required a swift implementation of a harmonized set of regulations to provide a rigorous discipline on monetary and financial markets, and a certification of the financial instruments that are introduced into the market.

5. It is necessary to rethink the institutional credit rating agencies and how they are operating under harmonized procedures and subjecting them to control and authorization of the autonomous and independent international authority.

6. We need to establish a civic or governmental control of the system and to strengthen the role of states in the operation of the new system.

7. We need at least a debate on the taxation of financial transactions and to establish an international fund for solidarity.

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