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Global Governance: *Adjustment* or *Reform* of the International Monetary System?

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ABSTRACT

Global public goods and the contrast to global public bads require a dramatic change in the international monetary system, enforcement capacity, democratic legitimation, the return to regionalism and multilateralism. Pending the emergence of a more equitable global reserve and payments system, an increased use of the Special Drawing Rights, channeled through Multilateral Development Banks, may help managing the transition towards the provision of such global public goods. This would also provide a guidance for the reduction of Central Banks' balance sheets, the financialization of the economy and an increase of real investment, thus anchoring the whole international economy to a less vulnerable and volatile monetary structure.

Keywords: global public goods, international monetary system, special drawing rights, multilateral development banks

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1. Introduction

There are a few doubts that climate change is currently widely recognized as a global public bad. Awareness is also rising as concerns the fact that, without concerted action by all humankind, any attempt to stop global warming and reducing lethal carbon emissions cannot effectively affect the whole planet.

The issue we are dealing with in this note is if the current architecture of the international economic and monetary governance is fit for providing global public goods and contrast global public bads. I anticipate that the answer is negative, but that there are a few steps that may be taken in the coming years to avoid wasting precious time for human survival.

Technicalities concerning, for example, the current status of reserve assets for SDRs can be rather easily overcome by political consensual decisions, and the negative impact of currently high interest rates on SDRs net positions can be reduced by a simple choice of the executive board of the IMF, as was suggested by Joe Stiglitz at the Emerging Market Forum meeting in Marrakech in October 2023. Some of these changes should take place before Multilateral Development Banks can intervene, but we believe that the current global political situation of increasing conflict should suggest that a consensus on a peaceful evolution might be found, the alternative being a dramatic change and fragmentation of the international economic and financial system that would hinder growth and progress.

I will start illustrating the problem of collective action at the international level and provide an overview of the evolution of attempts to reform the system (first section). I will then explain the potential role of (a modified version of) the Special Drawing Rights (SDR) in boosting investments related to the provision of such goods (second section); underline the opportunity given by the need to reduce the width of Central Banks' balance sheets to divert resources from short-term speculation to long-term investment (third section); before briefly illustrating that an interesting instrument for this,

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pending a major reform of the international monetary system, is an increased use of Multilateral Development Banks through which SDRs might be channeled (forth section).

2. A Common Commitment for Global Public Goods

The global nature of issues related to climate change (and other public goods/bads) and the problems associated with their production are well described in the economic literature (Kaul et al., 1999). Public goods are usually underprovided: free riders are likely to emerge each time externalities are not fully internalized, and social marginal benefits/costs do not reflect private marginal benefits/costs (Pigou, 1920).

While within nation-States (that match the administrative dimension in which policies can be enforced) this process of free riding can be effectively reduced, the production of transnational (public and/or merit) goods clashes with the usual problem of collective action (Sandler, 1998). As unanimity or consensual decision is the rule in supranational decision-making, collective choices concerning the provision of global goods ends up being set at sub-optimal level (Sen, 1970).

Hence the question whether the current architecture of the international economic, financial, and political governance is fit for the provision of the necessary amount of global public goods. And, in case it is not, whether such architecture requires only small adjustments or needs a dramatic change in nature, scope, and structure. This note, as I anticipated, suggests that the latter is the correct answer, although the path towards reform is neither easy nor plausible in the current geopolitical framework; some steps to manage the transition towards such goal can nevertheless be effectively implemented.

This issue is not new. It was raised several times in the past, since the emergence of widespread awareness of the global (or transnational) nature of some public goods, such as: resource constraints on growth in the early 1970s (Tinbergen, 1976) and sustainability issues since the late 1980s (Brundtland,

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1987); and financial stability after the 2007-08 financial crisis. The covid-related emergency further strengthened the perception that a wide-range of public goods are global in nature. During the financial crisis, demands for a major reform of the international economic and financial governance forcefully emerged in public debate and global institutions (Zhou, 2009).

At the G20 in London in April 2009 pressures were mounting for convening a Bretton Woods 2 conference, to reshape the balance of powers and redesign the governance of the international monetary system (IMS). On September 21, 2009, the UN Stiglitz Commission published its Report on Reforms of the International Monetary and Financial System suggesting new regulatory global institutions and a dramatic change of the nature of the economic and financial global framework.

In the meanwhile, suggestions were made for an increasing role of the IMF's multicurrency basket unit of account, such as an amended SDR to reflect the evolving balance of economic power in the world. The debate and proposals soon faded away, although pressures led to the insertion of the Chinese renminbi in the SDR's basket. The world had to wait until the covid pandemic to see the IMF issue the unprecedented amount of $650bn in SDRs in August 2021, six months before the Russian invasion of Ukraine halted any further attempt towards multilateralism.

Although the conflict froze concrete proposals towards multilateral governance of the international economic and political system, a renewed bilateral confrontation clashes against the need for global collective action and, sooner or later, a profound revision of the international system is needed. In this framework, we suggest that SDRs are a reasonable instrument to relieve multilateralism, especially if used to finance development and redistribution projects worldwide.

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3. A Potential Role of the SDRs

The SDRs were the result of an intellectual struggle that lasted for a few years during the 1960s. Thanks to initiatives led by Machlup, Fellner and Triffin (Connell, 2014) several groups of academics and policymakers reflected on possible reforms of the IMS in order to escape the so-called Triffin dilemma: the fact that international liquidity cannot be provided uniquely by an hegemonic country because, when demands for liquidity increase, the only way to provide it is through domestic and foreign payments unbalance in the pivot country (the USA), thus leading to the end of convertibility (Triffin, 1960).

The proposal to issue SDRs was therefore meant to supply a new, multilateral instrument for international liquidity. SDRs were indeed first issued between 1970 and 1972 (during the historical phase that brought to the end of the Bretton Woods regime and towards flexible exchange rates) precisely to provide non-gold (whose supply is inelastic) and non-dollar (whose extreme supply elasticity undermines the credibility of the system) liquidity to the international economic system. US hegemonic interests determined, until recently, an under-provision of SDRs, a typical example being the failed attempt by the then Managing Director of the IMF, Michel Camdessus (2014: 185-192) to issue some tenth billion dollars in SDRs in 1994.

SDRs are a basket currency, now including (differently weighted) five major currencies: US dollar, euro, renminbi, yen, and pound sterling. SDRs are issued by the IMF and distributed to each country following the capital key rule: each country receives a share of the issue depending on its share in the IMF capital. This means that the largest recipient of SDR is the USA, followed by other industrialized countries, implying that unless some redistributive measure is taken, this currency cannot be used to promote development in underdeveloped or developing countries. But it can be used to promote the production of global public goods, assuming that the most

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advanced economies contribute to their provision more than others.

When they were designed, during the Sixties, SDRs were thought of (also) as a source of potential financing to the economy, not as a mere reserve asset, and as a potential anchor to the international monetary system. Their current nature is still that of a reserve asset; but after the Covid a debate emerged as to the means to transform this money into spendable liquidity, not just as mere settler of international payments.

In August 2021 this debate culminated in the issue of $650bn of SDRs and suggestions emerged as to the ways to use this money to support development, increase the resilience of financial safety nets in specific areas, etc. Many countries in fact do not need balance of payments assistance and would simply keep SDRs as a reserve asset, without letting them circulate in the economy, which is economically inefficient. Hence the emergence of proposals to channel such SDRs for reducing development gaps and asymmetries, and promoting sustainable goals (Plant, 2021; Wolf, 2021; Masini, 2022).

One further step for their greater use would imply establishing a multilateral clearing for SDR operations, as was the case with the Bank for International Settlements (BIS) for ECUs. Again, it could be the BIS to take up the responsibility of this. This would pave the way to the private use of SDRs, assuming they are made convertible into claims held by central and private banks.

Let me add one remark on global liquidity and safe assets. We are living in an era of excess saving over investment, and these resources are channeled towards the only safe asset available worldwide: the US Treasury bond. This is happening also in these very years when the US GDP has been decreasing in global terms. This might eventually be leading to the impossibility for the US T-bond to keep pace with safe asset demand, the only viable alternative being euro-denominated T-bonds, irrespective of attempts by the BRICS to create alternative solutions. Nevertheless, euro-denominated T-bonds still represent only a tiny share of global liquidity and meet ideological resistance

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to EU indebtedness. The only viable alternative to the dollar and euro is an increasing role of the SDRs, so as to create some form of – flexible, as SDRs can be both issued and withdrawn – debt for the global economy, directed to the provision of global public goods.

4. From Financial Speculation to Investment

One of the most pressing worries of economists and policymakers in the last years has been understanding why Central Banks (CBs) seemed unable to counter undesired price dynamics, both deflation and inflation. The liquidity trap during the years of the quantitative easing before 2020 and the current inability to push inflation down seem to weaken the credibility of monetary policy as an effective policy tool.

Quantitative easing only resulted in an increasing financialization of the economy and an explosion of Central Banks balance sheets (Ghymers, 2021). Most commentators underline how the rush to the bottom of interest rates, even negative in some cases, pushed markets to abandon long-term investment (with promising but late-coming returns), and prefer high-yield short-term speculation (de Larosiere, 2022). In turn, this decreased aggregate demand, thus requiring new monetary expansions in the attempt to ignite growth. In a vicious circle that seemed to be unstoppable.

Following Wicksell’s logic, market rates below the natural ones resulted in overinvestment; more accurately, in misallocated investment in hot money, until and (mostly) exogenous events took place. Skyrocketing energy prices and upset global value chains, exacerbated by the Russian invasion of Ukraine, made inflation suddenly rise. Accordingly, Central Banks were forced to raise interest rates, thus further weakening any perspective for long-term investment in the real economy and dampening projects with long-term returns on investment.

There are several flaws in this – today dominant – logic. The first is that only in a neoclassical perspective interest rates do play a significant role in

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investment decisions, while in a Keynesian perspective they depend on the marginal efficiency of capital: a highly unstable and unpredictable, subjective assessment by entrepreneurs of the relative role of the cost of debt and cash flows deriving from returns on investments. If future demand is high and stable, companies do invest, despite the (high) absolute level of the cost of money. As a counterfactual testimony of this Pangestu, Pazarbasioglu and Stern (2023) observed that despite declining interest rates in the last two decades, real/productive investments dropped.

When uncertainty about the future prevails, a portfolio reflecting subjective propensity to balance risk choosing zero-yield risk-free bonds with high-yield speculative assets is preferred to long-term productive projects. Declining investment in the real economy, especially in Europe, reflected the endogenous flaws of its economic and strategic governance, that relies on unanimity decision-making processes, therefore uncoherent with the other major global actors. Had a supranational European budget existed, it would presumably have followed the USA and other regional aggregates in implementing strategic investments, thus reducing the fragility of both the real and financial sectors.

This leads to the second flaw, which concerns the role of fiscal policy, usually neglected in debates on the effectiveness of monetary policy. Monetary policy may fail in pushing to produce specific supranational (merit) goods, but an ad-hoc policy mix of coordinated fiscal and monetary policy might be quite effective. Again, the governance of the EU is uncoherent with the need to take timely and efficient decisions. Is there any way out, both at the European and global level? We suggest that a special role, in this process, may be played by Multilateral Development Banks (MDBs).

5. Managing the Transition: The Role of MDBs

The provision of a few global public goods is key for the survival of humankind. And cannot be waiting for a new institutional architecture that

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implies a deep revision of the geopolitical balance of power in the world. Managing the transition towards such goals becomes crucial.

One key actor that may help revitalizing multilateralism, at the same time strengthening regional ties and promoting long-term development investments, are MDBs (Andrews, 2021).

Considering that they are financial institutions, whose shareholders are groups of nation States, MDBs do not directly represent global choices; but they are particularly fit for a few steps that might be taken immediately in that direction.

Firstly, they are all prescribed holders of SDRs. The IMF recently added five more MDBs to the list of institutions that are allowed to hold and deal with SDRs, making them the most powerful agents in a transition towards greater use of such currency in development projects. Changing also the perspective concerning the global economic and financial architecture in a multilayered structure with the IMF at the central level and MDBs at regional level.

Second, they are precisely devoted to finance investments related to real-economy projects, such as infrastructure. From this point of view, they can ensure the landing of resources to the real economy. Third, they can mobilize and attract private capitals, thanks to their solidity (being assisted by national governments for their collateral) and the return on investment that investment projects ensure, providing also a potentially efficient mediation between State intervention and market forces.

In development projects, as well as in regional integration dynamics (Georgiou, 2022), private agents and their interests do represent a key element for the advancement of both. MDBs can provide the venue for such virtuous synergies to emerge between market, bottom-up pressures, and governmental, top-down choices.

Forth, being mostly characterized by geographical proximity, they allow for a better and more effective control, without the need to resort to strict and explicit conditionality rules, thus being more acceptable as a source of

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financing and more efficient in tackling regional spillover effects that usually characterize development projects.

6. Concluding Remarks

The IMS needs profound reforms to fix its shortcomings and face the current and forthcoming global challenges, that require a much more efficient structure than only relying on loose international cooperation. Enforcement and democratic legitimacy are urgent. As is manifest once again, once conflicts prevail over diplomacy, global public goods cannot be provided, and the world cannot afford delays in many areas, such as the struggle against climate change.

Pending a more radical reform of the IMS, we highlighted how an increased role of the SDRs as international money could help rescue multilateralization against bilateral confrontation. We also suggested that further channeling SDRs to MDBs might help strengthening regional integration and investments in the real economy, thus also providing a guidance for the sustainability of the increased CBs balance sheets.

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