

# [International monetary system](https://assignbuster.com/international-monetary-system/)

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International monetary systems are sets of internationally agreed rules, conventions and supporting institutions that facilitate international trade, cross border investment and generally the reallocation of capital between nation states. They provide means of payment acceptable between buyers and sellers of different nationality, including deferred payment. To operate successfully, they need to inspire confidence, to provide sufficient liquidity for fluctuating levels of trade and to provide means by which global imbalances can be corrected.

The systems can grow organically as the collective result of numerous individual agreements between international economic actors spread over several decades. Alternatively, they can arise from a single architectural vision as happened at Bretton Woods in 1944. Historical overview Throughout history, precious metals such as gold and silver have been used for trade, termed bullion, and since early history the coins of various issuers – generally kingdoms and empires – have been traded. The earliest known records of pre - coinage use of bullion for monetary exchange are from Mesopotamia and Egypt, dating from the third millennium BC.

Its believed that at this timemoneyplayed a relatively minor role in the ordering of economic life for these regions, compared to barter and centralised redistribution - a process where the population surrendered their produce to ruling authorities who then redistrubted it as they saw fit. Coinage is believed to have first developed in China in the late 7th century, and independently at around the same time in Lydia, Asia minor, from where its use spread to near by Greek cities and later to the rest of the world.

Sometimes formal monetary systems have been imposed by regional rules. For example scholars have tentatively suggested that the ruler Servius Tullius created a primitive monetary system in the archaic period of what was to become the Roman Republic. Tullius reigned in the sixth century BC - several centuries before Rome is believed to have developed a formal coinage system. [2] As with bullion, early use of coinage is believed to have been generally the preserve of the elite. But by about the 4th century they were widely used in Greek cities.

Coins were generally supported by the city state authorities, who endeavoured to ensure they retained their values regardless of fluctuations in the availability of whatever base precious metals they were made from. [1] From Greece the use of coins spread slowly westwards throughout Europe, and eastwards to India. Coins were in use in India from about 400BC, initially they played a greater role in religion than trade, but by the 2nd century had become central to commercial transactions.

Monetary systems developed in India were so successful they continued to spread through parts of Asia well into the Middle Ages. [1] As multiple coins became common within a region, they have been exchanged by moneychangers, which are the predecessors of today's foreign exchange market. These are famously discussed in the Biblical story of Jesus and the money changers. In Venice and the Italian city states of the early Middle Ages, money changes would often have to struggle to perform calculations involving six or more currencies.

This partly let to Fibonacci writing his Liber Abaci where he popularised the use of Arabic numerals which displaced the more difficult roman numerals then in use by western merchants. [3] Historic international currencies. From top left: crystalline gold, a 5th century BCE Persian daric, an 8th century English mancus, and an 18th century Spanish real. When a given nation or empire has achieved regional hegemony, its currency has been a basis for international trade, and hence for a de facto monetary system.

In the West – Europe and the Middle East – an early such coin was the Persian daric, of the Persian empire. This was succeeded by Roman currency of the Roman empire, such as the denarius, then the Gold Dinar of the Muslim empire, and later – from the 16th to 20th centuries, during the Age ofImperialism– by the currency of European colonial powers: the Spanish dollar, the Dutch Gilder, the French Franc and the British Pound Sterling; at times one currency has been pre-eminent, at times no one dominated.

With the growth of American power, the US Dollar became the basis for the international monetary system, formalized in the Bretton Woods agreement that established the post-World War II monetary order, with fixed exchange rates of currencies to the dollar, and convertibility of the dollar into gold. Since the breakdown of the Bretton Woods system, culminating in the Nixon shock of 1971, ending convertibility, the US dollar has remained the de facto basis of the world monetary system, though no longer de jure, with various European currencies and the Japanese

Yen being used. Since the formation of the Euro, the Euro has gained use as a reserve currency and a unit of transactions, though the dollar has remained the primary currency. A dominant currency may be used directly or indirectly by other nations – for example, English kings minted gold mancus, presumably to function as dinars to exchange with Islamic Spain, and more recently, a number of nations have used the US dollar as their local currency, a custom called dollarization.

Until the 19th century, the global monetary system was loosely linked at best, with Europe, the Americas, India and China (among others) having largely separate economies, and hence monetary systems were regional. European colonization of the Americas, starting with the Spanish empire, led to the integration of American and European economies and monetary systems, and European colonization of Asia led to the dominance of European currencies, notably the British pound sterling in the 19th century, succeeded by the US dollar in the 20th century.

Some, such as Michael Hudson, foresee the decline of a single basis for the global monetary system, and instead the emergence of regional trade blocs, citing the emergence of the Euro as an example of this phenomenon. See also Global financial systems , world-systems approach and polarity in international relations.

It was in the later half of the 19th century that a monetary system with close to universal global participation emerged, based on the gold standard. History of modern global monetary orders The pre WWI financial order: 1870–1914 From the 1870s to the outbreak of World War I in 1914, the world benefited from a well integrated financial order, sometimes known as the First age of Globalisation. [4] [5] Money unions were operating which effectively allowed members to accept each others currency as legal tender including the Latin Monetary Union (Belgium, Italy, Switzerland, France) and Scandinavian monetary union (Denmark, Norway and Sweden). In the absence of shared membership of a union, transactions were facilitated by widespread participation in the gold standard, by both independent nations and their colonies.

Great Britain was at the time the world's pre-eminent financial, imperial, and industrial power, ruling more of the world and exporting more capital as a percentage of her national income than any other creditor nation has since. [6] While capital controls comparable to the Bretton Woods System were not in place, damaging capital flows were far less common than they were to be in the post 1971 era. In fact Great Britain's capital exports helped to correct global imbalances as they tended to be counter cyclical, rising when Britain's economy went into recession, thus compensating other states for income lost from export of goods.

Accordingly, this era saw mostly steady growth and a relatively low level of financial crises. In contrast to the Bretton Woods system, the pre-World War I financial order was not created at a single high level conference; rather it evolved organically in a series of discrete steps. The Gilded Age, a time of especially rapid development in North America, falls into this period. Between the World Wars: 1919–1939 The years between the world wars have been described as a period of de-globalisation, as both international trade and capital flows shrank compared to the period before World War I.

During World War I countries had abandoned the gold standard and, except for the United States, returned to it only briefly. By the early 30's the prevailing order was essentially a fragmented system of floating exchange rates . [8] In this era, the experience of Great Britain and others was that the gold standard ran counter to the need to retain domestic policy autonomy. To protect their reserves of gold countries would sometimes need to raise interest rates and generally follow a deflationary policy.

The greatest need for this could arise in a downturn, just when leaders would have preferred to lower rates to encourage growth. Economist Nicholas Davenport [9] had even argued that the wish to return Britain to the gold standard, " sprang from a sadistic desire by the Bankers to inflict pain on the British working class. " By the end of World War I, Great Britain was heavily indebted to the United States, allowing the USA to largely displace her as the worlds number one financial power.

The United States however was reluctant to assume Great Britain'sleadershiprole, partly due to isolationist influences and a focus on domestic concerns. In contrast to Great Britain in the previous era, capital exports from the US were not counter cyclical. They expanded rapidly with the United States's economic growth in the twenties up to 1928, but then almost completely halted as the US economy began slowing in that year. As theGreat Depressionintensified in 1930, financial institutions were hit hard along with trade; in 1930 alone 1345 US banks collapsed.

During the 1930s the United States raised trade barriers, refused to act as an international lender of last resort, and refused calls to cancel war debts, all of which further aggravated economic hardship for other countries. According to economist John Maynard Keynes another factor contributing to the turbulent economic performance of this era was the insistence of French premier Clemenceau that Germany pay war reparations at too high a level, which Keynes described in his book The Economic Consequences of the Peace.

The Bretton Woods Era: 1945–1971 British and American policy makers began to plan the post war international monetary system in the early 1940s. The objective was to create an order that combined the benefits of an integrated and relatively liberal international system with the freedom for governments to pursue domestic policies aimed at promoting full employment and social wellbeing . 11] The principal architects of the new system, John Maynard Keynes and Harry Dexter White, created a plan which was endorsed by the 42 countries attending the 1944 Bretton Woods conference. The plan involved nations agreeing to a system of fixed but adjustable exchange rates where the currencies were pegged against the dollar, with the dollar itself convertible into gold. So in effect this was a gold – dollar exchange standard. There were a number of improvements on the old gold standard.

Two international institutions, the International Monetary Fund (IMF) and the World Bank were created; A key part of their function was to replace privatefinanceas more reliable source of lending for investment projects in developing states. At the time the soon to be defeated powers of Germany and Japan were envisaged as states soon to be in need of such development, and there was a desire from both the US and Britain not to see the defeated powers saddled with punitive sanctions that would inflict lasting pain on future generations.

The new exchange rate system allowed countries facing economic hardship to devalue their currencies by up to 10% against the dollar (more if approved by the IMF) – thus they would not be forced to undergo deflation to stay in the gold standard. A system of capital controls was introduced to protect countries from the damaging effects of capital flight and to allow countries to pursue independent macro economic policies [12] while still welcoming flows intended for productive investment.

Keynes had argued against the dollar having such a central role in the monetary system, and suggested an international currency called Bancor be used instead, but he was overruled by the Americans. Towards the end of the Bretton Woods era, the central role of the dollar became a problem as international demand eventually forced the US to run a persistent trade deficit, which undermined confidence in the dollar. This, together with the emergence of a parallel market for gold where the price soared above the official US mandated price, led to speculators running down the US gold reserves.

Even when convertibility was restricted to nations only, some, notably France,[13] continued building up hoards of gold at the expense of the US. Eventually these pressures caused President Nixon to end all convertibility into gold on 15 August 1971. This event marked the effective end of the Bretton Woods systems; attempts were made to find other mechanisms to preserve the fixed exchange rates over the next few years, but they were not successful, resulting in a system of floating exchange rates. 13] The post Bretton Woods system: 1971 – present An alternative name for the post Bretton Woods system is the Washington Consensus. While the name was coined in 1989, the associated economic system came into effect years earlier: according to economic historian Lord Skidelsky the Washington Consensus is generally seen as pning 1980–2009 (the latter half of the 1970s being a transitional period). [14]

The transition away from Bretton Woods was marked by a switch from a state led to a market led system. 4] The Bretton Wood system is considered by economic historians to have broken down in the 1970s:[14] crucial events being Nixon suspending the dollar's convertibility into gold in 1971, the United states abandonment of Capital Controls in 1974, and Great Britain's ending of capital controls in 1979 which was swiftly copied by most other major economies. In some parts of the developing world, liberalisation brought significant benefits for large sections of the population – most prominently with Deng Xiaoping's reforms in China since 1978 and the liberalisation of India after her 1991 crisis.

Generally the industrial nations experienced much slower growth and higher unemployment than in the previous era, and according to Professor Gordon Fletcher in retrospect the 1950s and 60s when the Bretton Woods system was operating came to be seen as a golden age. [15] Financial crises have been more intense and have increased in frequency by about 300% – with the damaging effects prior to 2008 being chiefly felt in the emerging economies. On the positive side, at least until 2008 investors have frequently achieved very high rates of return, with salaries and bonuses in the financial sector reaching record levels.

The " Revived Bretton Woods system" identified in 2003 From 2003, economists such as Michael P. Dooley, Peter M. Garber, and David Folkerts-Landau began writing papers[16] describing the emergence of a new international system involving an interdependency between states with generally high savings in Asia lending and exporting to western states with generally high spending. Similar to the original Bretton Woods, this included Asian currencies being pegged to the dollar, though this time by the unilateral intervention of Asian governments in the currency market to stop their currencies appreciating.

The developing world as a whole stopped running current account deficits in 1999 [17] – widely seen as a response to unsympathetic treatment following the 1997 Asian Financial Crisis. The most striking example of east-west interdependency is the relationship between China and America, which Niall Ferguson calls Chimerica. From 2004, Dooley et al. began using the term Bretton Woods II to describe this de facto state of affairs, and continue to do so as late as 2009.

Others have described this supposed " Bretton Woods II", sometimes called " New Bretton Woods",[19] as a " fiction", and called for the elimination of the structural imbalances that underlie it, viz, the chronic US current account deficit. [20] However since at least 2007 those authors have also used the term " Bretton Woods II" to call for a new de jure system: for key international financial institutions like the IMF and World Bank to be revamped to meet the demands of the current age,[21] and between 2008 to mid 2009 the terms Bretton Woods II and New Bretton Woods was increasingly used in the latter sense.

By late 2009, with less emphases on structural reform to the international monetary system and more attention being paid to issues such as re-balancing the world economy, Bretton Woods II is again frequently used to refer to the practice some countries have of unilaterally pegging their currencies to the dollar.