

Analysis of Innovation Opportunities in International Monetary System with Reference to the Emerging Trend of Globalization

Zhang Jianqing¹, Shahzadah Fahad Qureshi², Muhammad Saim Hashmi³

1 Economics and Management School, Wuhan University, Wuhan, P.R.China, 430072

2 Economics and Management School, Wuhan University, Wuhan, P.R.China, 430072

3 School of Economics, Huazhong University of Science and Technology, Wuhan, P.R.China, 430074

(E-mail: jqzhang@whu.edu.cn, sfq2005@hotmail.com, msaimhashmi@gmail.com)

Abstract With the start of global financial crisis, the international monetary system has entered into a new debate of reform. One dominant view in this debate is that the problems and their consequences, of the current international monetary system, are partial requirements of emerging trend of globalization, and will reach at peak in future. Lots of innovation opportunities in the present international monetary system have been discussed in the past. In this context, the question arises; which innovation opportunity can better fulfill the globalization requirements? We have analyzed the four most prominent innovation opportunities, in the light of, current and future requirements of globalization. The paper concludes that although issuance of IMF SDRs is revealed as comparatively better option, but every innovation opportunity has significant drawbacks those are requiring the close attention of the concerned economists and policy makers.

Key words Globalization Requirements for International Monetary System (IMS); Regional Economic and Monetary Union (REMC); International Monetary Fund's Special Drawing Rights (IMF SDR's); Keynes' International Clearing Union (ICU); Single global currency

1 Introduction

International monetary system played a very vital role in the development of the world in the 20th century until now. During the era of stable and integrated IMS, such as; from 1945 to 1970, we can see a substantial rise in all the economic indicators of the world, e.g. the world GDP grew by an annual average compound growth rate of 4.91% per annum between 1950 to 1973, while during the era of unstable and loosely connected IMS like from 1915 to 1944, we can see nominal increase or even decrease in all the economic indicators of the world, e.g. the world GDP grew by an annual average compound growth rate of only 1.85% per annum between 1913 to 1950^[1]. This critical role of IMS in world development requires attention for the development of a sound IMS.

Although various financial crises have adversely affected economies of the world during last few centuries but destructions to the world economy due to great depression of 1930s, and global financial crisis have no other example ever. Great depression led to the rethinking of IMS through Bretton Woods conference, and global financial crisis is again raising questions about the rethinking and the major reform of the IMS.

With the objective of major reform of the IMS in order to cope the situation after global financial crisis, lots of work has been done and being done by renowned economists. Richard N. Cooper (2009) suggested the expansion in IMF role^[2]. Jane D'Arista (2009) discussed the evolution of IMS in detail with a special focus on US role. He suggested to reform international payment system, creation of public investment fund and major changes in structure of SDR issuance^[3]. IMF Research department also contributed a lot. Mateos y Lago et al. (2009) discussed that the main weakness of the current IMS perhaps is the unavailability of mechanism to balance the current accounts of the countries specially the reserve issuing countries and this problem has been increased in the recent years with the increasing trend of emerging economies after the Asian crises to accumulate reserves to use as insurance measure against capital account crises. They compared 4 IMSs (including the current one) on 9 requirements and concluded that in spite of having various weaknesses, current monetary system is still a viable choice. The opportunities should be given consideration but a sudden jump to them will not be the wise decision^[4]. Blanchard and Milesi-Ferretti (2009) discussed the urgent need of implementing policy changes to save the global economy. They suggested the ways to overcome the domestic and systematic distortions^[5]. Flood et al. (2009) discussed the need of international risk sharing and suggested the measures to do so^[6]. In order to safeguard the economic interests of China and world, Chinese economists also explored reasons of global financial crisis and offered suggestions, including the widely cited speech of Zhou Xiaochuan, the governor of the central bank of China, to reform the IMS (2009), who suggested a move towards Keynes' Bancor through increased use of IMF SDRs^[7]. Considering

the seriousness of the issue, the president of United Nations General Assembly made a commission of Joseph E. Stiglitz and other renowned economists in late 2008, and assigned them the task to suggest measures to reform international monetary and financial system. The commission submitted its report in September 2009, offering key recommendations on some core issues including equal participation right of all countries in international decisions, formation of an international body to coordinate, implement and support the IMS, procurement of reserve sufficiency, stability provision, and maintenance of balance of payments etc^[8]. In its report, the commission said that the global financial crisis is complex and multi-faceted, and it is not possible to cover all issues in a short report.

In response to the global financial crises, lots of innovation opportunities for the IMS have been identified. Four of the most prominent opportunities are development of regional economic and monetary unions (REMC), issuance of IMF SDR's as international reserve currency, development of Keynes' ICU, and issuance of single global currency. But this is the one side of the picture and the other side of the picture is that world is becoming globalized with a very fast speed. This emerging trend of globalization requires that we should design an IMS that can not only overcome the problems of the present, but also has the potential to satisfy the requirements of the future. Our theory is that today problems are only the part of the emerging globalization requirements and these problems will increase in the future, with the increase in globalization. This paper is an attempt to analyze four prominent innovative opportunities of IMS, in the light of the current and future requirements of globalization. This study will add up to the current literature by; identifying the potential and prospective deficiencies of different innovative opportunities of IMS, in satisfying the requirements of globalization.

2 History and Comparison of Different International Monetary System

The IMS developed from the initial phases of central redistribution and barter system in ancient times. After the barter system, precious metals such as gold and silver in raw form were used for trade, termed bullion. The use of coin started from the 7th century BC from China. In the 14th century, the paper currency was started for the first time, again from China. Till 1860s, there were separate regional economies of Europe, Americas, India and China; those were loosely connected with each other. In the early 1870s, a monetary system was emerged, with somewhat global participation, named as gold standard system. The gold standard system, named because of its base on the gold standard, worked well till early 1900s partly for huge increase in the gold supply of the world, during that period (Arista, 2009). It ended in 1914, because of the WWI. During WWI, various economies issued more currency notes than gold reserves, in order to pay for war expenses and so abolished the gold standard system. After the end of WWI, because of destructive economies, it was very difficult for them to reinstate the gold standard system. The great depression and the US behavior during great depression worsened the situation for the whole world. At the end of WWII, a new IMS was launched with the name of Bretton Woods. U.S. dollar was the reserve currency of Bretton woods system that was, fixed to gold at a fixed exchange rate of \$35 per ounce, while all other currencies were fixed to the U.S. dollar at a fixed exchange rate. This system worked well till 1960 but then failed, mainly due to Tiffin dilemma and the U.S. economic policies in the late 1960s. Owing to the U.S. economic policies in the late 1960s, U.S. dollar became weaker and price of gold in open market increased from its official fixed exchange rate of \$35 per ounce, resulted in huge outflow of gold reserves from US. In order to stop outflow of gold, US had to end convertibility of U.S. dollar into gold on 15 Aug 1971, considered as the ending date of Bretton Woods System. From that day up till now, major economies of the world are following a floating exchange rate system, in which, currency value is determined by foreign exchange market, whereas most of the developing economies have linked their currencies to that of major economies.

Besides the main advantages of gold standard including predictable environment and current account balancing through price-specie flow mechanism, it was failed in WWI for its main disadvantage of "offering low or no autonomy in national monetary policy". Gold exchange rate standard was introduced through Bretton Woods's conference in 1944 and prevailed till 1971. Its main advantages were discipline, stability, certainty and coordination of economic policies but destroyed due to its main disadvantages of Tiffin dilemma and speculative attacks. However, the core advantages of current floating exchange rate system include control over national monetary policy and symmetry while its core disadvantages include uncertainty, discipline problem, uncoordinated economic policies and more importantly speculative attacks. Clearly the system of floating exchange rate offers least advantages and maximum disadvantages out of all three IMSs, discussed above. The world experienced severe financial crises in the short history of floating exchange rate system like the US crises of 1981, Asian

crises of 1997 and the last but not least and most critical crises of 2007. As a result, presently, innovation of the IMS has become key issue of international economics.

3 Innovation Opportunities for International Monetary System

The attention of international economy, these days, is towards finding a solution to the problems of IMS, discussed in previous sections. Various innovative opportunities have been identified by the renowned economists, to cope these problems. Most prominent opportunities for the development of IMS include regional economic and monetary unions (REMC), issuance of IMF SDR's as international reserve currency, development of Keynes' ICU, and issuance of single global currency. The first two opportunities have the advantage of being already in existence and hence getting more attention, while last two opportunities have the advantage of sound theoretical support.

Table 1 Globalization Requirements for International Monetary System

Globalization Requirements for IMS	Potential of Innovative Options of IMS to Fulfill Globalization Requirements (%)				Most favored option from our survey
	REMU's	IMF SDRs	Keynes' ICU	Single Global Currency	
(1) Assistance in Expansion of International Trade	21	27	25	26	IMFSDR
(2) Stability Provision	26	24	27	24	ICU
(3) Currency Base Diversification Over Maximum Number of Countries	26	28	29	18	ICU
(4) Based on Equal Participation Right by All Member Countries (No Super Power)	24	26	30	20	ICU
(5) Have an International Body to Implement and Support the System	17	29	27	26	IMFSDR
(6) Encourage Interest Free Economic Environment	26	28	26	20	IMFSDR
(7) Support Electronic Transactions and Development of Automatic Electronic Data Maintenance System	23	27	25	25	IMFSDR
(8) Offer Economic Justice to all countries (developed and developing)	24	27	26	22	IMFSDR
(9) Offer Coordination of All Member Countries	26	27	26	21	IMFSDR
(10) Provide Security Over Speculative Financial Flows	26	26	25	24	
(11) Procure Reserves Sufficiency	20	30	24	26	IMFSDR
(12) Offer Maintenance of Balance of Payments	22	28	26	25	IMFSDR
(13) Support Uniform Global Tax Rates	19	27	27	27	
(14) Establish Stable and Predictable Future Environment	21	29	29	21	
Over All Result	23	27	26	23	IMFSDR

In questionnaire, the respondents were asked to rate the ability of innovative options to fulfill the globalization requirements, on a rating scale of 1 – 5 (1 for minimum and 5 for maximum)

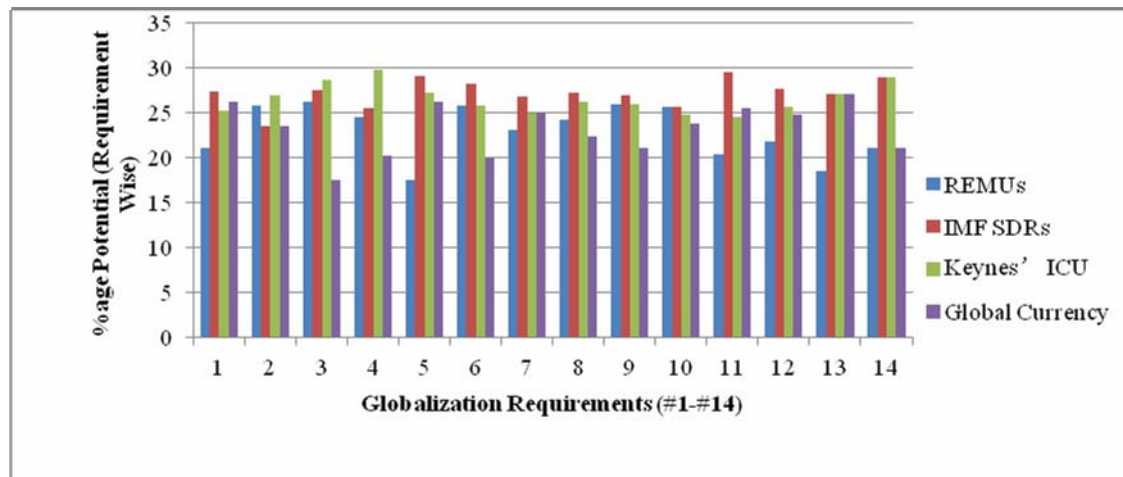


Figure 1 Potential of 4 Innovative Options to Fulfill 14 Globalization Requirements

4 Globalization Requirements for the International Monetary System

Following method was adopted for the identification of globalization requirements for the IMS and the potential of four innovative opportunities to fulfill those requirements.

4.1 Identification of the globalization requirements

The world is becoming globalized with a very fast speed from the final quarter of the last century and the major reason for the emergence of global financial crisis are the new requirements of globalization. In order to know about the globalization requirements for the IMS, first the relevant literature was analyzed. As the specific literature available on this issue was not fulfilling the requirement so, a focus group was requested to first to identify the globalization requirements for the IMS and then to select the most important among them. Focus group consisted of five Professors and doctorate students of the relevant research area from different countries. Focus group identified 14 major requirements of globalization for the IMS, as shown in Table 1.

4.2 Questionnaire design and data collection

A questionnaire was designed to collect data about the potential of four innovative options of IMS, to fulfill the requirements of globalization. A sample of 50 economic researchers of relevant area was selected for survey from all over the world, including the researchers from US, advance economies, emerging economies and developing countries, to have a viewpoint of all the stakeholders of the IMS. They were requested to give their opinion about the potential of four innovative options, to fulfill the requirements of globalization, those were identified by the focus group. The summary of their responses is given in the table 1. They were also requested to comment the four innovative options.

4.3 Data Analysis

The summary of data collected through questionnaire is shown (Table 2 and Figure 1). The data shows that economists have mixed opinion about the potential of innovative options of IMS to fulfill the globalization requirements, and revealed the need of further studies on this issue, until the economists get agree on a single option. According to overall result, 27% respondents considered the Issuance of IMF SDRs as having the maximum capacity to fulfill globalization requirements while 26% considered the Keynes' ICU as having the maximum capacity to do so. Regional economic and monetary unions and single global currency were considered by 23% respondents each. Although Issuance of IMF SDRs is revealed as comparatively better option, but no clear consensus on any single opportunity reveals that every innovation opportunity has significant drawbacks, those must be paid attention to have a smooth and comprehensive IMS.

5 Conclusion

The continued stream of severe financial crises after 1971 has again put the whole world in a situation of uncertainty with the latest most alarming global financial crises. The reasons behind these financial crises and the review of various international monetary systems of past and present are attracting the economists' attentions towards various issues. First, due to its problems of uncoordinated economic policies, unstable and unpredictable environment and speculative financial attacks; current IMS of floating exchange rate is the weakest among all the systems implemented in the world before

and it seems that it is the time to bring fundamental changes in the current system in accordance with the current world economic scenario. Second, as a solution to the problems of current floating exchange rate system, economists have given various innovative solutions including development of regional economic and monetary unions, issuance of IMF SDRs as international reserve currency, development of Keynes' ICU and issuance of single global currency. The analysis of these innovative options, by considering the world trend towards globalization, shows that although issuance of IMF SDRs is revealed as comparatively better option, but every innovation opportunity has significant drawbacks, those must be given attention by the concerned economists and designers of the new IMS. Keeping in view the importance of the reform of the IMS, this small scale study just identifies a new direction and offers base point for future large scale studies, to help in decisions of IMS reform.

References

- [1] Angus Maddison. *The World Economy: A Millennial Perspective*. Paris: Development Centre of the Organization for Economic Co-operation and Development, 2001: 262
- [2] Richard N. Cooper. Necessary Reform? The IMF and International Financial Architecture[J]. *Harvard International Review*, 2009, 30(4)
- [3] Jane D'Arista. The Evolving International Monetary System[J]. *Cambridge Journal of Economics*, 2009, (33): 633-652
- [4] Isabelle Mateos y Lago, Rupa Duttgupta, and Rishi Goyal. *The Debate on the International Monetary System*. IMF Staff Position Note, IMF Research Department, 2009
- [5] Olivier Blanchard and Gian Maria Milesi-Ferretti. *Global Imbalances: In Midstream?* IMF Staff Position Note, IMF Research Department, 2009
- [6] Robert P. Flood, Nancy P. Marion and Akito Matsumoto. *International Risk Sharing During the Globalization Era*. IMF Working Paper, IMF Research Department, 2009
- [7] Zhou Xiaochuan. *Reform the International Monetary System*. People's Bank of China. 2009 March (In Chinese)
- [8] Joseph E. Stiglitz. *Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System*. United Nations, New York, 2009, September 21