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SYMMETRIC GLOBAL ORDER WITH NATIONAL SELF-DETERMINATION AND NO HEGEMON: VISION AND REALITY

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ABSTRACT

This paper explores how today's global monetary order differs from Keynes' original vision, as captured by his early Bretton Woods drafts, and how we got here. It also speculates whether Keynes' ideas, specifically his vision for the global monetary order, are still relevant to the contemporary world, after 80 years have passed since the publication of *The General Theory*. The paper argues that Keynes' hope for a global order without a hegemon could be considered overly rational and maintains that it may be worthwhile to recall what Keynes himself wrote in his memoir *My Early Beliefs*: "civilization [is] a thin and precarious crust erected by the personality and the will of a very few, and only maintained by rules and conventions skillfully put across and guilefully preserved".

Keywords: global monetary order, Bretton Woods, Keynes' bancor plan, Capital flows, Financial crisis.
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Introduction

This paper explores how today's global monetary order differs from Keynes' original vision, as captured by his early Bretton Woods drafts, and how we got here. We will also dare a peek into the future and speculate whether the chances for realizing his vision may be getting any better. 80 years after the publication of *The General Theory of Employment, Interest and Money*, are Keynes' ideas, specifically his vision for the global monetary order, still relevant to the contemporary world?

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The classical gold standard and the global monetary disorder of the 1920s and '30s provided the background to Keynes' thinking about monetary matters. He took the gold standard as an institutional given up to and including his *Treatise on Money* and the deliberations of the Macmillan Committee. Britain's departure from gold in September 1931 and his theoretical breakthroughs in the *General Theory* then gave a liberating impetus to his thoughts on the global monetary order. Taking our theoretical cue from Keynes of the *General Theory*, we will explore the evolution of global monetary relations since the Bretton Woods order that Keynes helped to establish.

We find that the history of the global monetary order seems to rhyme: there appears to be a cycle featuring periods of relative order or disorder. The global financial crisis (GFC) of 2008/9 appears to have ended what may be described as a neoliberal order of U.S. dollar supremacy and globalized finance. The current state of disorder appears to somewhat resemble the interwar period, when Britain was no longer able to lead, but the U.S. not yet ready or willing to take over leadership either; while the global instabilities of the 1970s also come to mind. A lack of global leadership, a vacuum of power and lack of order and balance, poses its own challenges. This may or may not raise the chances of eventually realizing Keynes' vision of a symmetric global order with national self-determination and no hegemon.

Section 1 summarizes the essence of the theoretical breakthroughs of the *General Theory* and outlines some implications for economic policy while section 2 then zooms in on Keynes' concrete vision for the international monetary order. Section 3 revisits the actual post-war international monetary order that lasted until the early 1970s. Section 4 covers the neoliberal era, the period from the early 1980s until the GFC of 2008/9, which saw the re-emergence of U.S. dollar hegemony. The post-crisis global disorder prevailing today is the subject of section 5. Section 6 concludes.

1. The General Theory in Essence

Keynes' attack on "[neo-]classical economics" may be succinctly summarized as follows: of the two key market adjustment mechanisms in neoclassical thought the first, wage-price flexibility, supposedly ensuring "automatic" labor market adjustment, is highly risky and unreliable, while the second, the supposed interest rate mechanism transforming saving into investment in the capital market, does not even exist. According to Keynes, in monetary production economies neither the labor market nor the capital market work in the ways suggested by neoclassical economics. For one

thing, the neoclassical microeconomic analysis of the labor market – focusing on substitution – does not extend to the macro economy; a fallacy of composition is involved. For another, the neoclassical capital market is purely imaginary and loanable funds theory simply flawed; confusing money and saving (Bibow 2009).

According to Keynes' analysis in *The General Theory*, falling money wages are unlikely to yield higher employment other than through boosting external competitiveness – a route of adjustment that is unavailable to the world economy, any other closed economy, and any economy or region that is large enough to be primarily driven by domestic demand. The strategy of general wage deflation runs the risk of suffocating domestic demand, a risk that arises from: the likely redistributional effects of general wage cuts as harming labor incomes and undermining consumption, the likely uncertainty created by price level instability as undermining investment, and the likely vulnerabilities created in the banking system and among debtors in general as undermining the economy's financial structure.

Regarding interest rate theory, Keynes argues that a rise in thrift does not – at least not directly and immediately – lower interest rates and boost investment, but simply depresses aggregate demand. Interest rates are not uniquely determined by the "real forces of productivity and thrift", but instead *somehow* established in financial markets, weighing the liquidity, risk (or uncertainty) and return attributes of financial instruments and thereby setting the financial conditions that the [monetary production] economy has to adjust to.

In principle, interest rates can be subjected to deliberate control by the national monetary authorities – unless prevented or hindered by international constraints, that is. Alas, even if not so hindered, the monetary authorities may still fail to steer interest rates in line with domestic requirements, perhaps because they are misled by ill-grounded beliefs in some neoclassical interest rate market automatism.

Keynes' theoretical breakthroughs in the *General Theory* have a number of crucial implications for domestic economic policymaking. First, stability not flexibility of national wage-price *levels* is key to economic stability and the effectiveness of domestic macroeconomic policymaking. Second, the monetary authorities (of any larger economy) need sufficient policy space to establish interest rates that are in line with local – rather than global – economic conditions and requirements, i.e. financial conditions need to be aligned with the locally prevailing strength of domestic demand. Third, as monetary policy is not all-powerful, deliberate fiscal policy too needs to be part of (domestic) demand management. Forth, as the global economy is a closed economy any reliance on net exports (mercantilism) on the part of certain national economies has to be consensual and well-aligned with lo-

cal demand conditions elsewhere – or will likely lead to conflict and global instability.

Additionally, Keynes' theoretical breakthroughs in the *General Theory* and the guidelines for domestic economic policymaking implied therein also have complementary propositions for the requirements of a sound international monetary order. In essence, for the global monetary order to foster global growth and avoid international conflict, countries should be disabled to pursue mercantilist strategies but enabled to systematically attain domestic demand-led growth through deliberate management of their economies. Balance and stability in international relations presupposes sufficient national policy space and adequate incentives to use it; as well as disincentives to freeloading on external forces instead.

If each country had sufficient policy space and the incentive to deliberately manage domestic demand, while facing disincentives to opt for the mercantilist alternative, a tendency for simultaneity in expansion could be assured, as emphasized in the *General Theory*. National policies pursued by each country that target "an optimum level of domestic employment [are] twice blessed in the sense that [they help each country concerned and their] neighbors at the same time. And it is the simultaneous pursuit of these policies by all countries together which is capable of restoring economic health and strength internationally, whether we measure it by the level of domestic employment or by the volume of international trade" (Keynes 1936, JMK 7:349).

Earlier in the *Treatise on Money* Keynes had identified the following "*dilemma* of an international monetary system [namely:] to preserve the advantages of the stability of the local currencies of the various members of the system in terms of the international standard, and to preserve at the same time an adequate local autonomy for each member over its domestic rate of interest and its volume of foreign lending" (Keynes 1930a, JMK 6: 271-272).

In order to create and protect sufficient national policy space short-term capital flows need to be checked and controlled, and even long-term capital flows be managed to ensure that they are stabilizing and supportive of global growth and development.

In general, exchange rates can then be kept stable by way of cooperation but, as a safety valve, they need to be adjustable. In principle, exchange rates should adjust in line with national (productivity-adjusted) wage-price level trends to maintain balanced competitiveness positions and prevent free-riding and any buildup of unsustainable imbalances.

In case external imbalances do arise, exchange rate adjustments and other policy adjustments should follow rules and any adjustment pressures be symmetric, requiring both surplus and deficit countries to adjust. Put-

ting asymmetric adjustment pressures on deficit countries alone is prone to impart a deflationary bias into the system. Similarly, if countries had the option for competitive devaluation.

2. Keynes' Vision: "Bretton Woods 0" That Never Was

Keynes' original proposals for the post-war global monetary order were informed by his theoretical breakthroughs of the *General Theory* while also distilling his studies and criticisms of earlier monetary arrangements, essentially the gold standard. As a solution to the "dilemma" Keynes identified in his *Treatise on Money*, countries are meant to be in a position to apply the "central controls", i.e. macroeconomic policies designed to manage domestic demand, while operating within a global order of stable but adjustable exchanges rates. His envisioned global monetary order foresees symmetry and absence of any national hegemon (Bibow 2009).

In Keynes' proposed global monetary order neither gold nor any national currency, but a new international currency unit – in his third draft named: "bancor" – would provide the principal unit of account and focal point of the exchange rate system. Issued in the form of (overdraft) bank money by the "clearing union/bank", acting as the supranational central bank envisioned in the *Treatise on Money*, the bancor currency would also be the main form of international liquidity. Importantly, bancor was to be defined in terms of, but not convertible into, ("completely dethroned") gold.

In contrast to the world's stock of gold, growing randomly but inelastic in supply at times of emergency, bancor liquidity was perfectly elastic and ultimately under deliberate international control. While powerful national central banks could deviate from the (unwritten) "rules of the (gold standard) game" in the old days, there would be one set of written rules applying equally to all countries, in Keynes' envisioned bancor scheme.

National currencies have fixed parities in terms of bancor and member countries are equipped with quotas for bancor overdraft loans, unconditional up to certain thresholds. In case of imbalances adjustment pressures arise equally for both surplus and deficit countries as both would be paying interest on their credit or debit bancor balances, respectively.[1] Once their bancor clearing balances exceed certain thresholds in terms of their defined quotas, both surplus and deficit countries would become subject to quasi-automatic parity changes and/or internal policy adjustments.

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[1] Keynes' first and second drafts even foresaw that creditor balances in excess of the quota would be "transferred to the Reserve Fund of the Clearing Bank", i.e. 100 percent confiscated.

The actual degree of stability of exchange rates would thus largely depend on whether all members are equally successful at achieving optimum employment together with price stability. In other words, it would depend to a large degree on the relative success of nations in maintaining wage discipline and controlling inflation in fully employed economies; considered a political problem by Keynes.[2] In any case, Keynes (1943, JMK 26:33) was optimistic that "if the initial exchange rates are fixed correctly, [divergences in national unit labor cost trends were] likely to be the only important disequilibrium for which a change in exchange rates is the appropriate remedy". Should significant and persistent divergences in national unit labor cost trends arise, the conceived system of pegged but adjustable exchange rates would operate more like a crawling peg (as considered by Keynes both in the context of his Genoa conference proposal of 1922 and in "The means to prosperity" in 1933 [Keynes 1980 (1933)].

Temporary international payments imbalances are thus automatically smoothed and silently financed by official international bancor overdraft liquidity. Access to bancor liquidity is unconditional and fully automatic within certain limits. Bancor liquidity gets created and destroyed endogenously with temporary trade and payments imbalances. Official bancor liquidity is not subject to competition from either national reserve currencies or private short-term lending.

Keynes praised his "bancor plan" as the "substitution of a credit mechanism in place of hoarding" (Keynes 1942, JMK 25:114). This is important as any widespread urge to increased hoarding of international reserves in the form of gold creates a systemic deflationary force. His bancor plan is designed to overcome this in two ways. First, bancor liquidity is automatically created when the actual need for it arises as a means to bridge temporary trade and payment imbalances. This is the transactions motive for the demand for money at work in the international trade and currency sphere. Second, countries' overdraft credit lines should be sufficiently large to deter reserve holdings in excess of the requirements of trade – looking after the precautionary motive. One may add here that the speculative motive was to be kept in check by means of capital controls on "hot money" flows and rules for quasi-automatic exchange rate adjustment in case of more persistent and unsustainable imbalances. This rules out destabilizing exchange rate movements as driven by "carry trade" strategies.

The workings of Keynes' clearing union would also fundamentally differ from today's realities in other ways. Today, a country with stagnant

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[2] "The task of keeping efficiency wages reasonably stable (I am sure they will creep up steadily in spite of our best efforts) is a political rather than an economic problem" [Keynes 1980 (1943b): 38].

domestic demand typically faces currency depreciation, driven by diverging monetary policies (i.e. interest rate differentials), adding force to its reliance on external growth. In fact, there is nothing that deters countries from deliberately pursuing this essentially mercantilist policy. Instead, under Keynes' plan surplus countries are facing disincentives to pursue this route. First, an interest penalty is levied on creditor balances. Second, at some point a surplus country faces currency revaluation if it fails to boost domestic demand, raising the cost of failure through the resulting deflationary shock.

Similar checks arise for a country that tolerates excessive inflationary domestic demand growth. It starts with interest payments on its debtor bancor balances. And it ends with currency devaluation if inflationary domestic demand growth (or excessive wage inflation) is not reined in successfully. Under Keynes' scheme, with each country being granted the policy space that enables it to keep its own house in order, countries overall should tend to be in sync, yielding that simultaneous and balanced expansion in the world economy that was Keynes' aim and concern.

The mainstream view that floating exchange rates would tend to stabilize countries individually and the system as a whole is only valid under rare conditions. In particular, any benefits of floating are only mutual if a temporarily rising trade deficit is acting as a relief valve in the overheating country while the temporary rising trade surplus is supporting the recessionary economy's recovery, *with trade imbalances as caused by domestic demand growth differentials balancing out over time*. Yet there is nothing that assures that these conditions are generally met. In actual experience floating exchange rates can be destabilizing, imbalances persist and build up until breaking point is reached. The supposed benefits from all this are anything but mutual.

Apart from exerting symmetric adjustment pressures on both deficit and surplus countries, designed to hold the parts of the system together, prevent divergences and imbalances and any inherent deflationary bias, the international monetary system should also be "capable of deliberate expansion and contraction to offset deflationary and inflationary tendencies in effective world demand" (Keynes 1942g, JMK 25:169). Complementary international institutions could be designed to secure a tendency towards international balance through stabilization of the international investment and credit cycle, commodity price stabilization, and supplemental international support for reconstruction and development.

So ultimately Keynes thought that there was more to it than just creating an order that enabled and encouraged each country to keep its own house in order. There was also a need to create international institutions that would facilitate international cooperation and deliberate management

of the integrating ("globalizing") global economy. Importantly, in this process, *finance was meant to be primarily national rather than international, that is, largely excluded from globalization* (Keynes 1933b).

3. Bretton Woods 1 – and its Eventual Failure

We may now identify some key differences between Keynes' envisioned global monetary order ("BW0") and the order actually agreed at Bretton Woods ("BW1").

The U.S. dollar rather than any neutral international unit of account became the focal point of the Bretton Woods order.[3] Currencies were pegged to the U.S. dollar which, in turn, was convertible into gold at a fixed rate; at least for foreign monetary authorities. This means that the system was hegemonic and asymmetric. At least one national currency, the currency issued by the hegemon, served both national and international functions. And it also means that global liquidity was ultimately controlled by the hegemon, albeit subject to the supposed gold convertibility constraint.

Gold was therefore not quite "completely dethroned" yet. And with the existence of gold convertibility, the Bretton Woods order also retained the old threat of a deflationary bias that had been inherent in the classical gold standard. At least this was the case as soon as the constraint was perceived as becoming binding and thus limiting the hegemon's room for maneuver (Triffin 1961). Some scholars therefore describe the Bretton Woods order as a gold(-dollar) exchange standard rather than a U.S. dollar standard. But de facto the system worked much like a U.S. dollar standard. The supposed gold anchor was finally disposed of by the hegemon when it became too inconvenient; at which time the system was in disarray and about to dissolve anyway (Isard 2005).

With the U.S. dollar rather than bancor serving as international liquidity, there was also no need for an international "clearing bank", as had been foreseen in the Keynes Plan. Instead the International Monetary Fund (IMF) was modeled after the "stabilization fund" concept of the White Plan. It was charged with safeguarding the stability of the international monetary system and equipped with resources paid in by its members to provide conditional loans to countries in trouble. As Keynes had feared, the IMF became part of an apparatus enforcing the interest of its dominant

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[3] The post-WWII Bretton Woods order made the U.S. dollar's hegemonic status obvious, but the transition from the previous sterling order already began after WWI (Eichengreen 2011). Keynes observed in the Tract: "For the past two years the United States has *pretended* to maintain a gold standard. *In fact* it has established a dollar standard" [Keynes 1971 (1923): 197-198].

members rather than a politically neutral instrument and source of "ruthless truth telling".

Exchange rates proved far more rigid than Keynes would have liked. Both surplus as well as deficit countries resisted parity changes for as long as possible. Low-inflation countries such as West Germany resisted revaluation as a way to boost their competitiveness and generate (net) export-led growth. Countries with somewhat higher inflation rates such as France and Great Britain resisted devaluation for fear that this would amplify domestic inflation trends. In other words, Germany got away with its de facto mercantilist macroeconomic policies while other countries misused the system as a substitute for domestic mechanisms to secure wage discipline and price stability. Both strategies conflict with Keynes' vision of member countries prioritizing the pursuit of domestic goals by domestic policy means while respecting the adjustability of exchange rates as part of a symmetric order designed to maintain international equilibrium. BW1 lacked incentive and enforcement mechanisms to ensure more timely and symmetric adjustment.

The rigidity of exchange rates became also more of a problem and challenge since finance was gradually liberalized and started re-globalizing. In Keynes' clearing union all international payments are channeled through the national central banks and currency markets kept shut down. As currency trading and "hot money" flows reemerged, policy space for national central banks to steer local financial conditions in line with domestic requirements shrunk accordingly. Market optimists would say that market discipline over domestic politics got reestablished. The question is though whether that is really all for the national good – or mainly serving certain interests. The threat is that "financial globalization" might disempower national policymakers and undermine the aspired prioritization of domestic policy goals, leaving economies vulnerable; which might suite foreign creditor interests perfectly well though.

Of the complementary international institutions that Keynes envisioned only some ideas came to fruition. The IMF's role itself focuses on surveillance and emergency lending but does not include instruments to manage global economic activity or the global investment and credit cycle. Similarly, the Bank for International Settlement (BIS) too plays a certain surveillance role of globally active banks and provides a forum for international cooperation among central banks and financial regulators. The commodity buffer stock idea never took hold at all. While the International Bank for Reconstruction and Development (World Bank) was established as the IMF's sister institution in Washington to provide long-term loans to poor countries in support of development and poverty alleviation.

Keynes considered stable currency arrangements and deliberate macro-

economic management as a precondition for, and backbone of, free trade. While the original plan for an International Trade Organization floundered in 1947, the liberalization of international trade progressed in stages and ultimately very far, including the establishment of the World Trade Organization in the mid1990s. In the 1980s, the Washington institutions started peddling the idea that liberalizing and globalizing finance was a win-for-all strategy to promote global prosperity and stability (Fischer 1997, Dornbusch 1998).

All along, the currency hegemon, a position that was not foreseen in Keynes' global monetary order, came to enjoy special privileges and responsibilities. One privilege is greater freedom in prioritizing domestic policy goals than enjoyed in the periphery, another to earn income on the basis of issuing the currency that is also used internationally; in both cases increasingly more so as finance was globalizing. The responsibility is to provide direction and appropriate stimulus to the global economy, if needed, while anchoring global financial conditions and monetary stability. The hegemon's burden of responsibility too is getting bigger with financial globalization.

The starting position at the end of World War II was one of extreme imbalance. Much of the global gold stock was concentrated in the U.S., which ran a large current account surplus position and housed a strong economy undemolished by war; apart from being world leader in terms of technology and productivity as well. Other advanced economies, especially Europe and Japan, were in the doldrums. The developing world was only just beginning to emerge on the global economic and monetary scene. The Soviet Union and China were about to disappear. This global imbalance was an important consideration in Keynes' plans and negotiations concerning the post-war global order.

For the immediate post-war years Keynes foresaw the inescapable need for the U.S. to, in one way or another, provide huge loans to basically the rest of the world. His painstaking negotiations for a bilateral loan to his war-wrecked home country were part of this effort (Moggridge 1992, Skidelski 2000). But to overcome the more general and acute challenges arising from the initial global imbalance, he also envisioned a very large magnitude of overdraft bancor liquidity within his own scheme. In the event, the U.S. proved far less generous both regarding the British loan than Keynes had hoped for and the IMF's resources that the U.S. could agree to (which were only about a third of what Keynes considered appropriate global liquidity, especially in the early years).

As it turned out, however, it only took the U.S. a short while longer to appreciate that addressing the problem of the global dollar shortage was both inevitable and in its own best interest. Beyond the initial "Govern-

ment Aid and Relief in Occupied Areas" program the emerging Cold War and division of Europe convinced the U.S. of the merits of the "Marshall Plan" (and "Dodge Plan" in Japan's case). The U.S. continued to run small trade surpluses until the early 1970s. Apart from aid, the demand for U.S. dollar liquidity was met through acting as "banker to the world": sizeable U.S. FDI outflows provided a continuous source of U.S. dollars, with short-term monetary liabilities held by foreigners as the matching U.S. capital inflows. In light of the reconstruction boom and catching-up of Western Europe and Japan, the hegemon's responsibility was to provide restraint, acting as currency anchor.

In the late 1960s, while wage pressures were on the rise globally (at varying degrees), the need to provide global restraint increasingly ran into conflict with U.S. domestic ("Great Society") and global ambitions (Vietnam War). The hegemon decided that national policy goals had to take precedence over international responsibilities. The U.S. current account turned into deficit in the early 1970s. Hot money flows added to the plight. Peripheral countries at the receiving end of the "dollar glut" faced the choice of either accumulating dollar reserves or allowing their currencies to appreciate sufficiently.[4] As they were unwilling to do either, but converted dollars into gold instead, the U.S. finally cut the dollar lose from its supposed golden straight jacket on 15 August 1971.

A final attempt to maintain stable exchange rates after parity changes ("Smithonian Agreement") proved short-lived. Vast speculative capital inflows finally convinced West Germany and other countries in 1973 to let their currencies float upwards. The Bretton Woods era of pegged but adjustable exchange rates was over. Floating rates became officially acceptable and were widely promoted as a stabilizing mechanism supposedly offering countries national monetary policy autonomy; the "trilemma view".

The breakdown of the Bretton Woods order and arrival of floating exchange rates in the 1970s bore some resemblance to the earlier interwar period. Overall, the 1970s saw a multitude of global economic instabilities. The global rise in inflation underscored the rising popularity of monetarism and demise of Keynesianism. The U.S. dollar's hegemonic position became questioned. West Germany's deutschmark and the Japanese yen attracted rising interest as rival reserve currencies. Western Europe's initial attempts to stabilize exchange rates regionally proved unsuccessful. The Bretton Woods order had featured both asymmetries between hegemon and pegging periphery as well as within the West European periphery. In

4 At times countries like West Germany and Switzerland also resorted to capital controls to contain capital inflows.

Western Europe these asymmetries lived on as inflation divergences divided the European Community into a "hard currency" block, with the deutschmark as anchor, and weaker Latin currencies.

4. Re-Emerging US$ Supremacy: The Post-Bretton Woods Order until the Global Crisis

The U.S. dollar reemerged in revitalized fashion as the world's supreme international reserve currency in the early 1980s. Ultra-tight money designed to force down U.S. inflation was one key factor. At first the "Volcker shock" caused recession and unemployment. But when falling inflation combined with the Reagan administration's fiscal expansion and gradual monetary easing, the dollar surged. Dollar appreciation was driven by global growth divergences; as re-emerging U.S. economic strength contrasted with the weakness observed elsewhere in the world economy.

In the developing world, especially in Latin America, the Volcker shock led to a debt crisis. In the second half of the 1970s the developing countries concerned had taken on large amounts of foreign debts denominated in U.S. dollars and much of it in the form of shorter-term bank loans. This was part of the so-called "petro dollar recycling" and welcomed by the "stagflating" rich countries as supporting global growth. When interest rates then skyrocketed and commodity prices plunged many developing country borrowers found themselves insolvent – threatening the solvency of rich-country banks too.

Stagnation also characterized the situation in Western Europe. In 1981-2, a U-turn in macro policymaking occurred in West Germany. The authorities abandoned Keynesianism and adopted "supply side economics", combined with unconditional fiscal austerity. This followed the Bundesbank's earlier embrace of monetarism. In the context of the new regional "European Monetary System" (EMS), which included pegged but adjustable exchange rates (the "Exchange Rate Mechanism", ERM), France followed suit in 1983, choosing disinflation under Bundesbank leadership over stimulus. In effect, as the U.S. trade deficit surged, the U.S. acted as primary global growth engine. Corresponding with the dominance of the rich industrialized countries in the world economy at the time, the counterpart trade surpluses were concentrated in (laggard) Western Europe and (rising) Japan.

Whereas West Germany and Western Europe only experienced faster growth in the second half of the 1980s, Japan had recovered earlier and more strongly. In fact, fast Japanese growth inspired the imaginations of the day. The rise of Japan became a prominent theme, the yen a supposed

rival of the U.S. dollar. Meanwhile, Japan's asset price inflation shifted gear and Japan's banks turned more active globally too.

As excessive dollar appreciation became increasingly inconvenient for the U.S. the G5 Plaza Accord of September 1985 delivered a coordinated U.S. dollar depreciation. The Reagan administration was especially adamant in putting pressure on the Japanese authorities to boost domestic demand by monetary easing while allowing yen appreciation; in addition to negotiating "voluntary export restraints" as a more direct way of containing Japanese exports. Following the 1987 stock market crash the U.S. Federal Reserve and other central banks eased monetary policy once more. Additionally, the mantra of financial liberalization was taking hold, especially bank deregulation. Housing bubbles developed in many industrialized countries in the late 1980s, nourished by the rise in credit availability.

Housing bubbles burst eventually and much of the industrialized world entered recession around 1990-1, including the U.S. and Japan. Germany was the exception. As a latecomer in the 1980s upswing West Germany's economy had only gathered pace towards the end of the decade. Then German re-unification delivered an accidental boom that was out-of-sync with Western Europe and the rest of the world. For once, Germany was an engine of growth in the region, at least briefly. For the Bundesbank's reaction cut this episode short rather brutally, pushing Germany into a deep recession and blowing up the ERM along the way. As a welcome side-effect Western Europe got rebalanced by these events. But with the agreement on a German-style "Economic and Monetary Union" reached at Maastricht, countries aspiring to meet the "convergence [eligibility] criteria" of said union experienced a first taste of what Germany's obsession with "stability orientation" really meant: protracted stagnation.

The global recovery and boom of the 1990s was thus rather similar to the 1980s: principally U.S.-led. This time round fiscal expansion played no part in it. The long "Clinton boom" (and "dot.com" bubble) were solely driven by private debt and spending, both corporate and household. Once again acting as global growth engine the U.S. current account deficit surged.

By contrast, following its decade of high hopes of the 1980s, tailed by bust in the early 1990s, Japan has been a growth laggard ever since. Europe's euro aspirants were also late to join the upswing. Apart from benefiting from U.S. growth, the euro "periphery" (to-be) received a boost from interest rate convergence to (lower) German levels. So growth accelerated towards the end of the decade, reducing budget deficits sufficiently for the euro's launch in 1999.

In addition to the U.S. engine, emerging market economies in East Asia were achieving fast growth at the time. In the 1980s, the mantra of financial liberalization had also started to spread beyond the rich industrialized

countries. As the Federal Reserve cut its policy rates sharply in the early 1990s this encouraged capital flows towards the global periphery opening up to such flows in the name of the "Washington Consensus". As during the first episode of capital flows reaching developing countries in the 1970s, these countries too suffered severe crises on the back of capital flow surges. The "Asian crises" of the late 1990s proved both severe and contagious. Contagion spread globally among emerging markets, reaching Russia, Turkey, Brazil and Argentina in due course, for instance. The U.S. Federal Reserve eased its stance in response in 1998, which propelled and prolonged the U.S. boom.

The emerging market crises of the late 1990s and early 2000s triggered a pronounced shift in macro policy orientation across the developing world. Having experienced the downsides of both fickle capital flows and crisis "support" from the IMF, developing countries at large from now on put safety first and opted for defensive macro policies.

Crisis resolution and recovery typically involve currency depreciation to restore competitiveness. A widespread shift in current account positions, from deficit to surplus, was observed as crises unfolded and currency depreciation restored competitiveness. In the aftermath of the crises maintaining competitiveness then became a policy priority. Foreign exchange reserve holdings across the developing world started soaring as countries intervened in currency markets to maintain their competitiveness and "self-insure", i.e. build up large buffers of foreign exchange ammunition to avoid having to rely on the IMF for support ever again.

Meanwhile, riding the final stage of the boom, the U.S. economy, with some support from other industrialized countries, even including Germany for a year or two, was strong enough to withstand and compensate for the immediate global repercussions of the emerging market crises. Things were quite different after the "dot.com bubble" had burst.

In 2001-2, the global economy was facing a serious challenge: The U.S. engine had stalled. America's overextended corporate sector embarked on de-leveraging. Japan and Germany had sunk into stagnation mode anyway. And now the developing world, by and large, too was playing safe and prioritized competitiveness and exports.

As a result, the U.S. authorities were forced into unprecedented macroeconomic policy action. At the fiscal policy front the U.S. budget balance swung from a surplus in the final Clinton years to a deficit of close to 6 percent of GDP in the early 2000s under the new G.W. Bush administration. Alas, the huge fiscal swing bought relatively little stimulus as too much of it arose from tax cuts for the rich and wars fought on foreign shores. So the Federal Reserve was forced into extraordinary easing action too: it lowered its Fed funds rate target to only 1 percent, a record-low level; while the U.S.

Treasury deflated the former "strong dollar" policy and talked down the dollar.

The impact of monetary easing and broad dollar depreciation on the U.S. and global economies was uneven and unbalanced, but peculiarly powerful. In the U.S. itself, the one sector that would respond strongly was the housing sector. Once again related to financial liberalization, a new – hitherto credit constrained – class of borrowers and source of housing demand was unleashed through innovative "subprime" mortgage lending. This helped to lift property markets in general. As little else would expand, least corporate investment and U.S. industry, employment growth in the U.S. was primarily driven by housing and the inflating property bubble.

The impact of the Fed's easing was also particularly powerful across the world – because countries generally prioritized competitiveness. In an increasingly financially globalized world this meant that countries had to either join the Fed and ease sufficiently and/or intervene in currency markets to keep their currencies from appreciating too fast, too much. *Financial globalization translated the Fed's easing into an unprecedented global monetary easing.* Central banks that did not follow suit were punished by currency appreciation. The Eurozone stands out in this regard as the ECB was quite welcoming a strong euro (following its initial plunge). The global economy experienced a record global boom but, as Martin Wolf (2012) observed, "between 2001 and 2005, the Eurozone was the sick man of the world economy".

China's rise was another factor of utmost importance in all this. China had begun opening up its economy to foreign investment and trade in 1978. Following the devaluation of 1994 the renminbi was pegged to the U.S. dollar; a peg that even held steady throughout the Asian crises. While China remained largely closed off from financial globalization, the country had low inflation and easy monetary conditions anyway. In 2001, China then entered the WTO. At that time the country had enjoyed two decades of fast growth and had now attained a size of some global significance. Especially because China's growth was highly "commodity intensive": fast Chinese GDP growth translated into surging demand for the export output of commodity producers. While the U.S. consumer, on the back of lax mortgage lending and a property bubble, acted as global "borrower and spender of last resort", China thereby helped spreading the stimulus globally throughout the developing world at large.

The record global boom of the 2000s provoked both concerns and well as complacency. The U.S.'s ever-rising current account deficit, which peaked at nearly 6 percent of GDP in 2006, attracted widespread concerns. Many observers and policymakers thought that "global imbalances" were a sign of vulnerability and not sustainable. In general, observers thought

that the U.S. was becoming overstretched and was facing an eventual dollar crisis (Roubini and Setser 2005, Frankel 2006). However, a highly influential alternative view, the so-called "revised Bretton Woods II hypothesis" (Dooley *et al.* 2003), held that the "imbalance" actually reflected a lasting symbiosis between creditors and the U.S. debtor, and was thus sustainable. What most observers were missing was that U.S. overspending and the global boom were ultimately powered by an unsustainable credit and property bubble.

A number of ideas and hypothesis concerning certain phenomena observed at the time were put forward. For instance, Summers (2006) identified a "global capital flows paradox". How was it possible that poor countries were sending their saving flows to rich countries and accumulated low-yielding reserves – when mainstream neoclassical theory predicted the opposite direction for capital flows. Related to the same kind of puzzling phenomena Federal Reserve chair Bernanke (2005) launched his "saving glut hypothesis", which says that the excess saving of current account surplus countries, such as China and Germany, depressed interest rates and thereby found their way through the global capital market into U.S. housing investment. Again, related to the same phenomena, his predecessor at the Fed Alan Greenspan saw a "bond market conundrum" in the fact that U.S. long-term interest rates failed to respond and stayed low despite tightening by the Federal Reserve starting in 2004.

What these ideas and hypotheses have in common is their roots in mainstream neoclassical theory – with the flawed loanable funds theory of interest at its core. These observers therefore all misread the key causal relationships that were shaping global developments at the time.

Our historical narrative above identified that ever since the U.S. dollar reemerged as global currency hegemon in the 1980s, under conditions of increasingly globalized finance and as part of a global monetary non-order, the U.S. economy came to act as global growth engine. For most of the time the U.S. exercised "benign neglect" regarding any current account deficits it ramped up while fulfilling this engine role. The challenge increased over time as more and more countries came to rely on exports for their growth, prioritized maintaining a competitive exchange rate and/or accumulate foreign exchange reserves for self-insurance purposes. The greater the urge of other countries in seeking safety in exporting and accumulating reserves, the greater the pressure on the ultimate producer of U.S. dollars to stimulate national (over-)spending and provide the sought-after U.S. dollars.

To do so, the U.S. is not at all dependent on any saving flows from either rich or poor foreign nations. U.S. dollars are produced by the U.S. banking system (with a helping hand through lending by the U.S. shadow

banking system and euro dollar markets), the eagerness of which is fired up by the Federal Reserve's monetary policy stance and (sufficiently lax) financial regulation and supervision. The causal role of foreign nations does not run through any imaginary saving flows, but stems from their efforts to maintain competitiveness and accumulate dollars. Their joint pursuit of defensive macroeconomic policies generates deflationary forces in U.S. product and labor markets. Following its domestic policy mandate the Federal Reserve is responding to these deflationary pressures.

Naturally, part of U.S. spending on goods and services enticed by the Fed and the banks "spills over" into foreign economies, just as part of U.S. lending and asset acquisitions enticed by the Fed and the banks do so as well. Of course, according to national income accounting conventions, foreign countries' current account surpluses correspond to (excess) saving on their part. But the national income identities do not reveal the critical causal forces at work. The foreign saving flows only come into existence as the U.S. overspends. U.S. overspending is based on U.S. dollar liquidity, not foreign saving. The situation may be properly described as a "global dollar glut" (Bibow 2008, 2009; see also Shin 2012, Borio and Disyatat 2011, Borio *et al*. 2014).

Correspondingly, the global financial crisis of 2008/9 featured, at its heart, a severe global dollar shortage that embodied an acute risk of a global financial system meltdown and global depression. Fragilities had been building up in the U.S. and global financial systems over many years. In 2005-6, U.S. property markets peaked and then started to turn down. In the first half of 2007, problems concentrated in the "subprime" mortgage segment began to crystallize. In the summer of 2007, investment vehicles experienced difficulties in rolling over their short-term U.S. dollar funding of increasingly suspicious and illiquid asset portfolios (constructed from complex and opaque financial instruments). The central banks concerned began providing emergency liquidity in August 2007.

The U.S. economy then entered recession at the end of 2007. Problems and fears regarding the U.S. financial system escalated. The Lehman bankruptcy in September 2008 proved a climactic event. It turned out that while the Eurozone had not been party in global imbalances (in the sense that the Eurozone's current account was roughly balanced prior to the crisis), banks from the region had been very active in the U.S. mortgage lending boom (Shin 2012, Borio *et al*. 2014). They were thus also immediately at the forefront of global financial institutions caught short of U.S. dollars and hit hard by losses stemming from their adventures in innovative U.S. mortgage products.

Under normal conditions U.S. dollars (and U.S. dollar loans) are mainly produced by private banks active in the U.S. (and by extension in euro dol-

lar markets) while the Federal Reserve only sets the price (and regulations), but is otherwise generally passive. In a crisis, a global dollar glut can turn into a global dollar shortage quite abruptly. Simultaneously, U.S. based financial investors might seek safety at home and international investors, too, flee to the U.S. "safe haven", while banks dump assets and call loans (i.e. destroy dollars). All-round distress selling, if left to itself, will result in debt deflation.

Only the U.S. Federal Reserve can stop the financial meltdown and fill any global dollar shortage by acting as international "lender of last resort" (LOLR) – as it in fact did in the event. The exorbitant privilege attached to the U.S. dollar is best seen at work in crisis: The Fed enjoys more leeway to act as LOLR, both nationally and internationally, than any other central bank; as a result, the U.S. is facing a very soft liquidity constraint, if at all. For the same reason the U.S. holds very low foreign exchange reserves; apart from its, for historical reasons, large gold stock.

5. Post-crisis Disorder and the Fading Basis of US$ Supremacy

When the Federal Reserve acted as LOLR (and/or "market maker of last resort") in the recent global crisis, providing U.S. dollar emergency liquidity both nationally and internationally, it employed a whole variety of channels and programs. Globally, the two most important measures addressing the U.S. dollar liquidity crunch where the Term Auction Facility (TAF) and central bank liquidity swaps. As an extension of its traditional discount window, the TAF, used between December 2007 and April 2010, was the main mechanism through which the Fed provided (auctioned) credit to (member) banks based in the U.S., including many larger European banks. Also in December 2007, the Fed arranged bilateral currency swap lines, initially only with the ECB and Swiss National Bank but then also extended to a dozen other central banks, enabling these foreign central banks to meet U.S. dollar funding needs of institutions in their respective jurisdictions. These and other complementary crisis-related measures offset the drying up of private U.S. dollar liquidity and averted the impending meltdown of the global financial system.

Central bank cooperation prepared the ground for a successful rebooting of the global financial system, which included the unleashing of a fresh wave of capital flows towards the developing world starting in the summer of 2009. As the Federal Reserve cut its policy interest rate to zero and launched several rounds of large-scale asset purchases ("quantitative easing", QE), this established a strong "push" force for international capital flows as soon as some degree of confidence returned to markets. The post-

crisis surge of capital flows fired up by the Federal Reserve came along with large exchange rate movements that prompted criticisms from recipient countries. Brazil's finance minister Guido Mantega famously referred to "currency wars". The remainder of this section will analyze some key developments in the global economy and financial markets since the global crisis of 2007-9, focusing on trends that pertain to the global monetary (non-)order and U.S. dollar hegemony.

In a series of papers I outlined the potential emergence of a new global monetary order that I dubbed "Bretton Woods III" (BWIII; Bibow 2010a,b, 2012a). I ventured that not even the global financial crisis with its origin in the U.S. at the center of the global financial system would end U.S. dollar hegemony anytime soon. Instead, the much fretted about pre-crisis "global (current account) imbalances", featuring quasi-permanent U.S. current account deficits, would continue at a diminished scale.

This hypothesis contrasted with the view that the pre-crisis global imbalances were unsustainable and would end in a dollar crisis. But it also contrasted with the "Bretton Woods II" hypothesis that saw those global imbalances as sustainable but missed that underlying domestic trends in the U.S. were clearly not so (Dooley at al. 2003, 2008, 2009). An important irony was that the "toxic waste" churned out by the U.S. financial system mostly stayed in the U.S. (or ended up on European balance sheets) while the rest of the world was busy accumulating safe assets (U.S. treasuries and government-backed securities). In contrast to BWII, BWIII posited that fiscal spending and public debt had to replace private spending and private debt as a more durable engine behind U.S. over-spending.

In a way, BWIII was coming about by default as the U.S. private sector retrenched abruptly while the U.S. government was stepping in with its "Obama (fiscal) stimulus"; apart from allowing the automatic fiscal stabilizers to do their job. Looking beyond the immediate crisis response, I suggested that the U.S. government was facing the opportunity for a continuing boost to public investment with the aim of upgrading America's infrastructure. In view of the likely rise in the household saving rate, the U.S. should pursue a steady and sizeable public investment program. Instead of enticing another private borrowing binge, as under BWII, under BWIII steady public borrowing and spending would take on the role of acting as U.S. and global growth engine. It is important that historically, except for the aftermath of the Volcker shock, the U.S. has benefited from a favorable constellation between nominal GDP growth and the interest paid on the national debt.

Internationally, under BWIII, public sector overspending would provide the very debt material that is in high global demand due to the U.S. dollar's international status. Regarding the external sustainability of persistent cur-

rent account deficits, I elaborated on the U.S.'s so-called "exorbitant privilege" as issuer of the key global reserve currency. A peculiar fact is that the U.S. enjoys a surplus on its income balance despite a sizeable negative net international investment position (IIP). Said privilege consists of several constituent parts. For instance, there is a yield advantage on U.S. direct investments over the yield on U.S. treasury securities. Valuation effects also tend to play an ample role in the U.S.'s case and, over time, have typically worked out as valuation gains rather than losses (Gourinchas and Rey 2005).

I highlighted that the status of the U.S. dollar enables the U.S. to engage in what I dubbed "dollar leveraging": the capability to lever any given yield advantage and/or valuation gains by running a gross foreign asset position that is a multiple of the U.S.'s (negative) net IIP. And this is where the Fed's monetary policy, the U.S. dollar's international role, and financial globalization come together.

Monetary easing by the Federal Reserve entices global financial investors, and especially U.S.-based ones with easy access to U.S. dollar funding, to embark on foreign asset purchases based on the international purchasing power of U.S. dollars created by the U.S. banking system. Typically, such U.S. dollar-based purchase waves (and the corresponding U.S. capital outflows) will tend to drive up foreign currencies and asset prices wherever they show up as capital inflows. Inevitably, the U.S. dollars "send abroad" actually stay within the U.S. banking system and also show up as U.S. capital inflows of one type or another. *Financial globalization matters here because it has greatly enlarged the scope for dollar levering.*

Ironically, financial globalization has enlarged the U.S. capacity for dollar levering precisely because it has raised the desire for seeking safety in U.S. dollar reserves in the rest of the world. In other words, by making the world a more precarious place, financial globalization allows the U.S. to boost its exorbitant privilege. The U.S. dollar may appear to have enjoyed a more hegemonic position under the Bretton Woods system of fixed exchange rates; as official anchor. But the demand for U.S. dollar reserves was actually far more limited at that time. According to mainstream legend exchange rate flexibility reduces countries' vulnerability and the need to hold any reserves. In actual fact, today's global monetary (non-)order in conjunction with financial globalization have massively raised the demand for global dollar liquidity – and hence also the dollar issuer's ability to exploit any advantages derived from that privilege.

However, the resulting global balance is a precarious one. Rocked at its foundations in the global crisis, it will become increasingly more difficult to sustain the precarious global order of U.S. dollar supremacy in the future. For one thing, the U.S. IIP has taken a big hit since the global crisis: valuation effects used to work in America's favor, but not so more recently. For

another, ongoing trends in the global economy show a shifting balance in power and economic weight away from the currency hegemon.

Occurrences since 2009 have vividly illustrated the precariousness of today's arrangements. Two phases may be distinguished. The first lasted from 2009 until May 2013. It was characterized by extreme monetary easing on the part of the Federal Reserve, unleashing another wave of capital flows towards the developing world. The notion of currency wars made headlines during this first phase as the U.S. dollar depreciated strongly. The second phase started with the so-called "taper tantrum" that was triggered by Federal Reserve chair Ben Bernanke's announcement that the Fed's QE would not continue forever, but tapering begin in the foreseeable future. The Fed then embarked on slow-motion "normalization" of its monetary policy stance at the end of 2013. The first actual interest rate hike only occurred in December 2015. And it took another full year for the second one to arrive. Capital outflows, currency depreciation, and widespread fragility in the developing world describe the second phase – as the U.S. dollar appreciated strongly across the board.

No doubt, in the aftermath of the global crisis, the domestic economic situation in the U.S. was more challenging than ever before. With the benefit of hindsight one may probably attest that the fiscal stimulus was, if anything, too small. It was definitely too brief. Following the loss of the Obama administration's congressional majority in 2010, U.S. fiscal policy undertook a premature turn to austerity in 2011. This put the burden of upholding the recovery squarely on the Federal Reserve's shoulders, which pursued aggressive monetary easing like never before. The objective was to stimulate domestic demand. Inevitably, global spillovers were massive, too.

While the developing world at large, too, was significantly affected by the immediate crisis at the center of global finance, many developing countries shared none of the crisis legacy issues that were subsequently holding back the recovery in advanced economies. The global boom of the 2000s had left many developing countries in good macroeconomic shape. External positions were mostly strong as a result of the defensive macro policies pursued prior to the crisis. And so were private sector balance sheets and government budgetary positions in general (UNCTAD 2010). With short-term interest rates quickly cut to zero and long-term interest rates pushed down by the Fed's large-scale bond purchases, developing countries in healthy shape and far higher interest rates were the obvious target for the new capital flows avalanche. Recipient countries were under pressure to cut interest rates – shrinking all-too alluring interest rate differentials – and intervene in currency markets to contain the appreciation of their currencies.

Fired up by unprecedented monetary easing on the Federal Reserve's part, from 2009 until 2014 brisk growth across the developing world was

key to sustaining the global recovery as growth in the U.S. was rather sluggish and the Eurozone stuck in protracted recession. Strong capital inflows had their usual effects in pushing up currencies and asset prices. Many developing countries experienced consumption booms while their nonfinancial corporate sectors loaded up their balance sheets with U.S. dollar denominated debt. Federal Reserve-led global monetary easing propelled domestic demand in the developing world while it happened, but it also caused fragilities and left these countries vulnerable – vulnerable to reversing capital flows and dollar appreciation. That of course has been the story of the last few years as numerous developing countries have gone through sharp slowdowns, recessions, or even crises (Acharya *et al.* 2015, Caballero *et al.* 2015, 2016; Domanski *et al.* 2016, McCauley *et al.* 2015, Sobrun and Turner 2015, Tarashev *et al.* 2016).

Among developing countries China is today by far the most important one. During the global boom of the 2000s China had amplified the growth impetus provided by the U.S. household sector's borrowing binge, spreading demand to commodity producers in particular. In the aftermath of the global crisis China became an even bigger and more essential driver of global growth. Its relative weight in the global economy has increased sharply as advanced economies were only growing sluggishly (or even stagnating or shrinking).

Due to capital account management China's degree of financial integration in the global economy is lower than other prominent developing countries'. And owing to its managed exchange rate regime China's renminbi has also appreciated more steadily and more gradually vis-à-vis the U.S. dollar since 2005. Nonetheless, significant fragility has built up in China since the global crisis, and for similar reasons as elsewhere in the developing world: faced with the collapse of the former global growth regime developing countries had to transition to new growth models at super-fast speeds. The switch to debt-fueled domestic demand regimes effectively forced upon them by extreme Federal Reserve easing, capital flows and currency appreciation, proved unsustainable soon enough.

In a way, the financially globalized world economy seems to have come full circle today. The emerging market crises of the 1990s had convinced the developing world to seek safety in defensive macro policies. These policies worked in the sense that the developing world was generally in good shape when the global crisis hit in 2008-9. Meanwhile, defensive macro policies in much of the developing world paired with sluggish growth in key advanced economies (Japan and Eurozone) put ever greater pressure on the U.S. to overspend. Given the legacies of the previous (corporate sector) crisis the U.S. household sector came to lift that burden alone – until it broke its back. Through extreme monetary easing the buck was

passed on to the developing world next – until their economies turned shaky too.

Today, the rest of the world is once again hoping for more constructive spillovers from "Trumpflation". But that will all depend on how serious the new U.S. administration is going to get about shifting international trade and manufacturing in America's favor through protectionist measures. It appears that the U.S. may refuse to play its traditional (exorbitantly privileged) role as spender of last resort, but may even take a turn towards mercantilism itself. That would starkly contradict the logic of (laissez-faire) financial globalization identified above: the more precarious the global monetary and financial order, the greater the demand for "insurance" to be provided by the key reserve currency issuer.

Or have initiatives and reforms since 2008 made the global monetary and financial order sufficiently safer?

Reforms did happen. The unashamed naivety about globalized finance that ruled prior to the crisis was dented. Some re-regulation has been implemented, designed to make the global financial system and banks in particular safer and less prone to crisis. The authorities have added "macroprudential" supervision to their toolkit: a sharpened focus on systemic as opposed to microeconomic risks. As a related matter, there has even been some re-thinking regarding "capital flow management", which is now more widely accepted; at least temporarily when all else has failed.

Regarding the global monetary order, the most important development is that central bank swap lines between the Federal Reserve and key central banks were made permanent. Furthermore, the IMF's resources, governance structures, and functions have been subject to reform since the global financial crisis. In April 2009, the G20 agreed to increase the resources available to the IMF through expanded New Arrangements to Borrow (by up to USD 500 billion) as part of a global plan for recovery, bringing the resources available for the IMF's lending function to approximately USD 1 trillion. In addition, a new SDR allocation of USD 250 billion was agreed to provide the membership with liquidity to address the crisis. In 2010, the membership then agreed on a quota reform to double the IMF's paid-in resources permanently; which, due to delays in the U.S. Congress, only came into effect in January 2016.

The IMF has also established new lending instruments. The enhanced Flexible Credit Line (FCL) and the Precautionary and Liquidity Line (PLL) have been designed to shield countries with sound fundamentals from liquidity crises caused by external contagion. Both facilities require the fulfilment of certain prequalification criteria (ex ante conditionality) but entail no (FCL) or streamlined (PLL) ex post conditionality. Today, the IMF also pays more attention to systemic risks and interdependencies, as witnessed

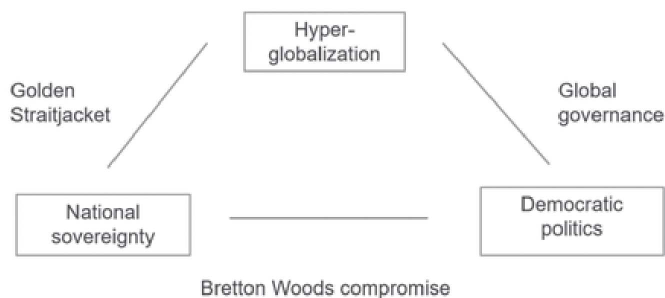
by its "Spillover" Reports, for instance. In addition, the IMF plays a supporting role in the G20's "Framework for Strong, Balanced, and Sustainable Growth". The key idea behind establishing this framework in 2010 was to prevent the reemergence of global imbalances.

Yet, overall, the developing world continues to favor self-insurance over the IMF's collective insurance instruments (Gallagher 2014, 2015, Helleiner 2014). In light of China's ongoing challenge to contain renminbi depreciation the country's fast-shrinking foreign exchange reserves no longer seem all that outsized. Meanwhile, the G20 "Framework" is not working either. Global imbalances shrunk only temporarily, but are on the rise again, with the Eurozone generating the biggest surpluses today.

6. Concluding Observations: Will Keynes Reign in the Long Run?

A number of observers have compared the euro with the classical gold standard. According to Rodrik's "globalization trilemma hypothesis", submitting to "hyper-globalization" under the "golden straitjacket" wreaks havoc to democratic politics even as national sovereignty is upheld. This would seem to describe the fate of Europe's EMU rather well even as the euro is found to be in certain ways even more constraining than the "barbarous relic". Perhaps the failed euro experiment also teaches us something about globalization.

Chart 1: Rodrik's (2011) "political trilemma of the world economy".



Crucially, the troubles at issue here do not only arise under fixed exchange rates, but are similarly pertinent under flexible ones. As "currency wars" made headlines in the aftermath of the GFC the mainstream literature started engaging in a "trilemma versus dilemma" debate (Rey 2013). According to the challenger of conventional wisdom, the "dilemma view", an important reality of financial globalization is that flexible exchange rates do not actually provide national policy autonomy either – as proponents of

the "trilemma view" have always been keen to assert. This is of course no news to the Post-Keynesian literature on currency hierarchies (Belfrage *et al.* 2016, Kaltenbrunner 2016). And it is also why Keynes emphasized the need to curtail financial globalization as part of a global monetary order that provides both some degree of exchange rate stability and sufficient national policy space to prioritize the pursuit of domestic policy objectives; the achievement of which the authorities in sovereign states remain politically accountable to at the national level.

Rodrik (2011) dubbed this solution the "Bretton Woods compromise": countries retain their national sovereignty and can operate democratic politics, but they have to forego the neoliberal ideal of hyper-globalization, especially financial globalization and the constraints it places on national policy space. In this kind of compromise global order countries neither submit to any golden straightjacket nor establish global governance. Today, we know that even Europe has failed to establish workable regional governance to maintain democratic politics in the context of its hyper-regionalization adventure. How likely is it that the global community will succeed doing so anytime soon?

As argued above, the Bretton Woods compromise diverged from Keynes' original proposal (BW0) in significant ways. The United States has been the global monetary hegemon from the days of BW1 until today. Under BW1, apart from transfers, U.S. dollar liquidity was mainly provided through U.S. FDI outflows, meeting the periphery's limited need and willingness to accumulate U.S. dollar reserves. The system broke down when the U.S. failed to provide sufficient restraint. U.S. dollar hegemony got a fresh boost in the 1980, as the neoliberal age of excessive financial globalization and exchange rate volatility took off. As crisis experiences convinced countries to pursue defensive macro policies, raising the demand for U.S. dollar liquidity, this also raised the pressure on the U.S. to offset the resulting deflationary bias through sufficiently lax macro policies. When it was America's turn to experience crisis first-hand the U.S.'s exorbitant privilege showed in the fact that the U.S. was free to apply very aggressive countercyclical macro policies while acting as international LOLR.

Meanwhile, we have seen another wave of capital flows firing up the developing world – before reversing and leaving recessions and instability in its trail. The U.S. and the developing world seem to be taking turns in going through boom-bust cycles while temporarily acting as growth engines, or laggards.

Today, there is growing political resistance in the U.S. itself against laissez-faire globalization and its perceived impact on the U.S. economy. Naturally, dollar overvaluation – due to its reserve currency status – exposes the U.S. tradable sector, specifically manufacturing jobs, to extra challenges

from global competition. But this is neither the cause of unemployment nor rise in inequality in the U.S., which reflect domestic policy choices rather than globalization per se. For the other side of the coin is that the reserve currency issuer can over-stimulate domestic demand and expand its non-tradable sector accordingly, while notoriously overspending as a nation.

Be that as it may, the U.S. under its new government appears to be unwilling to fulfil the global engine role. Given the U.S.'s shrinking global economic weight it is becoming ever harder for the U.S. to play that role anyway. But it appears the U.S. is even contemplating protectionist measures. If such initiatives proved successful, the reserve currency issuer might even come to act as a drag on global growth. At the same time, it appears U.S. financial policies may revert to the neoliberal deregulation mantra. Most likely, this would, once again, also unleash global forces in the same direction. A world of laissez-faire financial globalization equipped with a reserve currency issuer that shies away from its global responsibilities as global growth engine would only add to the contradictions afflicting the global monetary nonorder.

All along the rationale for financial globalization remains grounded in the mainstream view that the developing world needs to import saving from richer countries to fill its local saving gap. When financial globalization resulted in exactly the opposite constellation this caused some puzzlement among proponents, but no questioning of the underlying loanable funds theory of interest – identified as the central flaw in (neo-)"classical" thought by Keynes 80 years ago.

From Keynes' perspective finance – not saving – is the gatekeeper that allows investment and economic activity to occur, or not. In principle, liquidity can always be produced locally by the national banking system; normally under the guidance of the national authorities (Bibow 2008-9, 2012b, Kregel 2015). The critical question is whether either the direction and/or the aggregate provision of finance may be more or less likely to be determined wisely when fickle foreign forces are allowed to interfere in national economic management. Keynes held strong doubts, the mainstream strong faith in the wisdom of globalized financial markets.

So are the chances improving for Keynes' vision to be realized in the long run?

Global monetary history appears to rhyme, and current times seem to resemble the unstable global order of the interwar period and the 1970s. Meanwhile the global economic balance continues shifting. China (and sometime soon India) is (will be) the rising economic power(s) to reckon with. Between 2005 and 2014 China was cautious in managing a gradual appreciation of its currency; aware of the fate that earlier befell Japan. China has also been cautious in managing its financial account; all too aware

of the fate of others that do not. As a side-effect, for the time being, these policies restrict the renminbi's role as reserve currency. Perhaps China only intends to change course once its economy is even more equal (and less vulnerable) globally. In any case, going forward, developments in China, today's global growth engine no. 1, would seem to be the most critical factor.

Unfortunately, the new U.S. government seems to have confrontation rather than cooperation on its mind, viewing China mainly as a rival rather than a potential partner. It took global calamities to prepare the ground for BW1. The road leading today's multipolar world towards a multipolar currency system, one without a singular hegemon, perhaps even BW0, may be a bumpy one.[5]

Perhaps Keynes was overly rational in hoping for a global order without a hegemon. Perhaps Keynes' vision presupposes a (forever) peaceful world – while global monetary hegemony is also (or even primarily) about political/military power. Illusory or visionary? It is telling that Keynes also thought of his BW0 proposal as "a measure of financial disarmament". At the time of the Great Depression, Keynes (1930), the forever-optimist, praised the "Economic Possibilities for our Grandchildren". Today, as the world economy continues struggling for new balance in the aftermath of the Great Recession, with populist sentiments at risk of political capture, it may be worthwhile to recall from Keynes' (1938) "Early Beliefs" that "civilization [is] a thin and precarious crust erected by the personality and the will of a very few, and only maintained by rules and conventions skillfully put across and guilefully preserved."

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