

# International Money and the International Monetary System - A Global Public Good Perspective -

Hitotsubashi University and IMF joint seminar

on

The Future of International Monetary System for Asia

March 8-9, 2017

# Why do we have money?

- Money as
  - Medium of exchange = reduction in cost of exchange
  - Unit of account = ability to compare and make economic decisions
  - Store of value = smooth consumption
- Required Characteristics of Money
  - General acceptability, stability of value, low handling cost
    - ~ physical properties: easy to store/handle/transport; usable for a wide range of value; difficult to forge (easy to detect forgery); retains value.
    - ~ historically, precious metals (gold, silver); then fiat money (non-convertible bank notes)
    - ~ today, predominantly bank deposits

# Money as a Public Good

- Money itself is a private good
- The *system* of money is a public good
- The public good properties of a system of money include:
  - ✓ General acceptability
  - ✓ Stability of value
  - ✓ Access and Liquidity
  - ✓ Long-term stability of supply

# How is the monetary system as a public good supplied?

- Unlike a standard public good, the issue is not mainly about the cost of providing the public good.
  - Supplier of money enjoys seigniorage
- How can a monetary system be ‘supplied’?
  - Spontaneous development (network externality)
    - but may not be able to exhibit all the desirable properties
  - Government intervention to enhance acceptability
    - Preserving trust in money, and avoiding situations that may result in high transaction costs (forgery, hyperinflation, etc.)

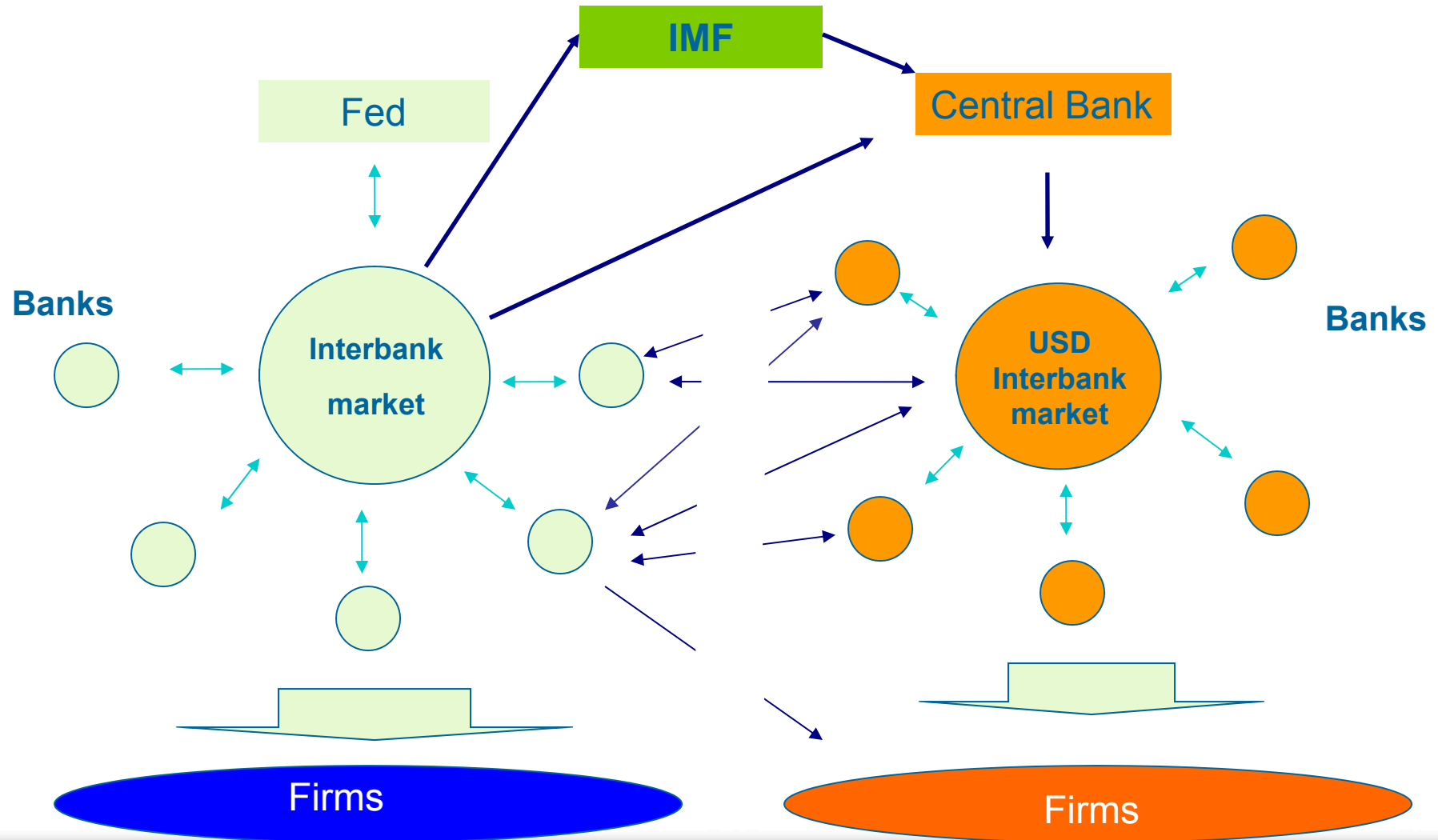
# International Money

- Facilitates cross border transactions
  - Same basic requirements as domestic currency
- In practice, use *domestic currencies* (no separate pure ‘international currency’)
  - Can domestic currencies fulfill the requirements for money at an international level ?
  - Being an international currency has costs in addition to benefits.
- Who ‘supplies’ the public good aspect of monetary system?
- What mechanisms can be installed to ensure stability of supply?

## Potential issues with the international use of national (fiat) currencies: *It's our currency but everyone's problem*

	Mechanism in domestic system	Potential issues when used internationally:
<b>General acceptability</b>	Sovereign guarantee and enforcement. Network externality.	Possibility of exchange control, sudden and widespread loss of faith.
<b>Stability of value</b>	Monetary policy for price stability Banking regulation	Exchange rate movements (divergence and unpredictability in real returns)
<b>Access and Liquidity</b>	Banking regulation Lender of last resort Helicopter money (fiscal policy)	Access to issuer country banking system. Possible dysfunctional system. Provision of LOLR function to international users.
<b>Long-term supply</b>	Money supply growth to support economic growth	Dependent on issuer countries' monetary policy

## The 2008 GFC as a crisis in the supply of international money



## The international monetary system: System to ensure the functioning of international money

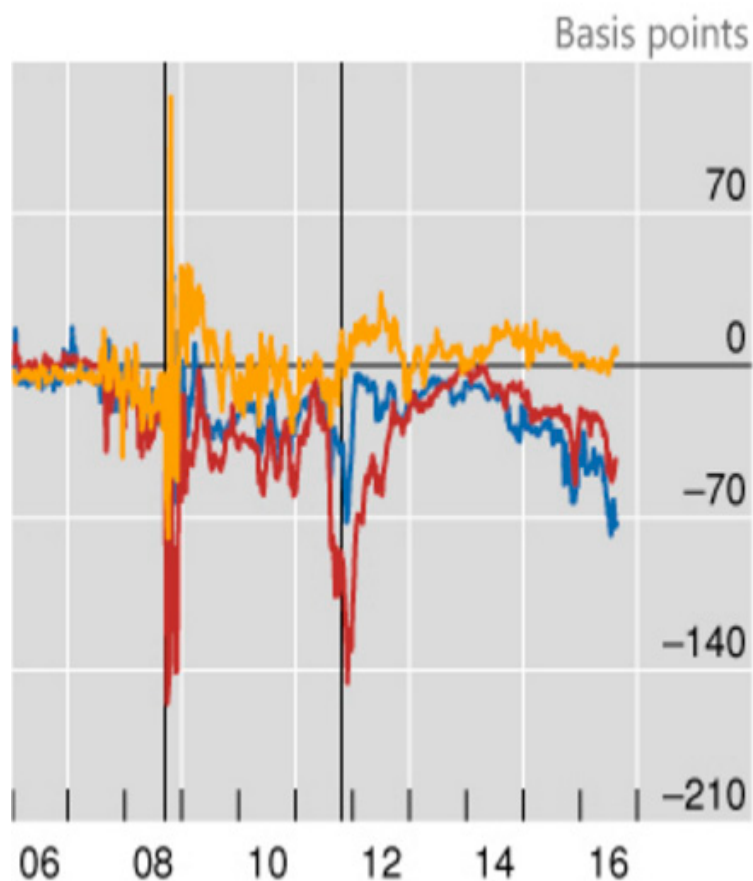
Features	Bretton Woods System (gold-dollar standard)	Multiple international currencies (but with dollar dominance)	
		Mechanism to ensure feature	Institutional/Systemic support needed to:
General acceptability	Current account convertibility and gold backing (IMF Articles)	General acceptability as a national currency and full convertibility	Avoid restriction of convertibility.
Stability of value	Dollar pegged to gold. Currencies pegged to dollar - changes in peg require IMF approval	Market discipline and self-interest of issuing authorities	Avoid excessive fluctuation of bilateral exchange rates. Prevent competitive devaluation.
Access and liquidity	Capital control = money accumulation through current account surplus and limited borrowing. IMF lending in BOP crisis	Market access through global financial system.	Maintain access to int'l and US banking system. Maintain financial stability in issuing country and global markets. Provide LOLR support.
Long-term supply	Dependent on US BOP deficit (Triffin's dilemma)	(Relative) national monetary policies.	Deal with declining size of US economy relative to international use



# Challenges for a system of multiple international currencies

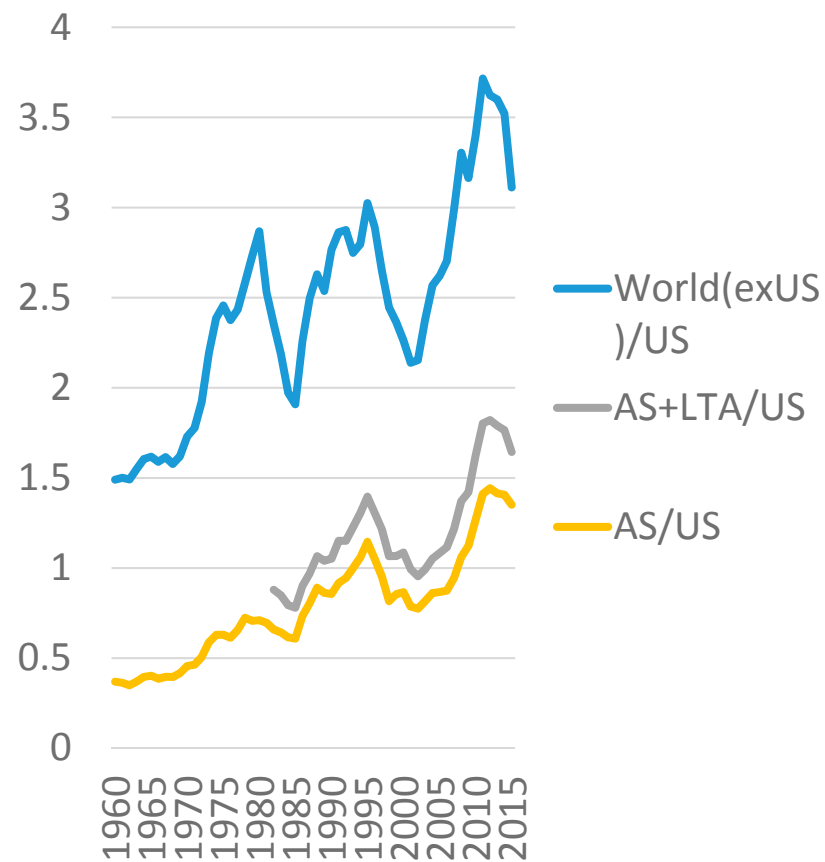
- General acceptability
  - No international rule on capital account convertibility (OECD code has no enforcement capacity)
- Stability of value
  - Currency substitution
  - IMF exchange rate policy surveillance does not extend to macroeconomic policy mix.
  - Global Imbalances (overhang of dollars?)
- Access and liquidity
  - Access to international banking services constrained by tougher regulation on AML/CFT and capital adequacy, etc..
  - Breakdown of Covered Interest Parity and increased dollar funding costs in non-crisis situations: a dollar 'shortage'?
  - Concentration of global banks and vulnerabilities in some of the major banks.
  - Financial regulation of banking systems in advanced economies have been tightened, with (hopefully) reduced probability of systemic crisis, but domestic LOLR and fiscal backstop capacity have been curtailed.
  - IMF and regional liquidity support mechanisms (ESM, CMIM) have been strengthened, but timeliness and adequacy of support not clear.
- Long-term supply
  - Network externality favors concentration, but concentration results in disproportionate use of the currency relative to the size of issuing economy, potentially raising questions as to the ultimate redeemability of the currency and hence general acceptability.

### Three months cross-currency basis against the US dollar



Source: Claudio Borio et. al., 'Covered interest parity lost: understanding the cross-currency basis', *BIS Quarterly Review*, Sept 2016

### Relative size of the dollar bloc to the US economy



Note: Ratio of nominal dollar GDPs. AS: Asia; LTA: Latin America. Data from World Bank. Regional and world aggregates do not include those countries whose data are not available, including non-member countries such as the Soviet Union prior to 1990

# Visions for the future of international money

- What the GFC revealed
  - risk of relying on US dollar
- Is there an alternative?
  - Greater use of non-dollar currencies.
    - Which currencies? Can they fill dollar's shoes?
    - A currency basket to reduce the 'burden' on a single currency?(c.f. SDR)
  - Back to gold?
  - Artificial currency – SDR?
    - SDR (Special Drawing Rights) is a reserve 'currency' that was artificially created (but not itself international money) to supplement global liquidity, but is in essence an overdraft facility at the IMF as well as a numeraire for IMF operations.
      - Its value is determined as a basket of five currencies (\$,€,¥,£,RMB)
      - IMF members are 'allocated' certain amounts of SDRs by crediting their account at the IMF
      - IMF members can 'use' SDRs by presenting it to another member, who is required to provide a foreign currency from their own reserves.
      - Interest are charged/paid on difference of SDR holdings against allocations (i.e. net use)
      - As a rule, only IMF member countries can hold SDR accounts with the IMF.
    - SDR **denominated** transactions can be and are done by the private sector, but they are not transaction in SDR itself
    - SDR allocations can potentially improve access to international currencies (as in 2010)
  - Artificial currency: Bitcoins?
- Could institutional mechanism be strengthened to maintain the global public good characteristic of the US dollar dominated system?
  - The role of IMF and other international arrangements.



*Thank you*

