



**THE FOUNDATION OF A COOPERATIVE GLOBAL FINANCIAL  
SYSTEM**

**A NEW BRETTON WOODS TO CONFRONT THE CRISIS OF THE  
INTERNATIONAL ROLE OF THE US DOLLAR**

by  
**ALFONSO IOZZO**  
&  
**ANTONIO MOSCONI**

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# The Foundation of a Cooperative Global Financial System

A new Bretton Woods to confront the crisis of the international role of the US dollar

Alfonso Iozzo & Antonio Mosconi

The crisis of the international role of the US dollar is progressive and irreversible. In strictly financial terms it manifests itself in the unsustainable level of US foreign debt, heavier year after year because of the current account deficit, in turn growing and almost insensible to the devaluations of the dollar thus far decreed by the financial markets. In political terms, it manifests itself in the incapacity of the United States to supply those global public goods which constitute the counterpart of hegemony.

The globalisation of the world economy, made possible by scientific means of production and the end of the cold war, requires the provision on the same scale of the public goods (such as security, legality, equity and environmental sustainability) which can no longer be supplied by an hegemonic power and in whose absence the market is incapable of self government. The United States, after the end of the cold war, attempted to ensure unilaterally the governance of the world economy, basing it on Wall Street and the Pentagon, thus forgetting the historical experience of the unsustainability of empires due to the growing costs of defence not justifying the advantages of dominion.

This attempt has failed. If it had succeeded the political superstructure corresponding to the era of the scientific means of production would have been the imperial. But this is not the case. On the contrary, throughout the world, the requirement for a multilateral, shared and democratic management of the globalised economy is being developed. A requirement which must be urgently satisfied if we want to arrest the forces of disruption which threaten to

take history backwards: to protectionism, macro and micro nationalisms and war.

The crisis was written into the genetic code of the international monetary system created by the Bretton Woods Conference: with the dollar (that is, the currency of one of the participants in the game and not a neutral currency) at its centre, the system would have brought about situations of dollar shortage in the case of a positive US balance of payments, and dollar inflation in the opposite case, according to the famous "Triffin dilemma". In the early post-war years there was a shortage of dollars and subsequently inflation. The world became multipolar with the emergence of the economic power first of Europe and Japan, then the emerging countries, China today and soon India. The centrality of the dollar disappeared with the creation of the euro and the decoupling of the *yuan* and other currencies, such as the Argentinean *peso*, from the American currency. If we want to avoid a ruinous fall in the dollar and ensure exchange rate stability as a foundation for globalisation and development, it is necessary to start again from Bretton Woods, correct its defects, put a world basket at the centre of the system and entrust its management to truly multilateral institutions.

## Bretton Woods

At the beginning of 1942, when the fortunes of war were already leaning towards the Allies, Keynes made a desperate attempt to salvage a role for the United Kingdom, alongside with the United States, in the structure of the post-war international monetary system. He thus proposed the construction of an international

currency union based on a currency, the *bancor*, with a fixed, but not immutable, content in terms of gold and accepted by all the members for the payment of international debts, to stimulate the expansion of trade and world economic development. The proposal, which was intended to internationalise the creation of liquidity so as not to leave it completely in the hands of the United States, was made by the British government in 1943 and inspired the Bretton Woods Conference of 1944, in which however the plan designed by White, chief international economist at the US Treasury, prevailed. White's plan reflected the power relationships coming from the military and economic results of the war, imposing the recognition of the US as the new hegemonic power. The enormous British debt to the United States to support the war effort (*Lend Lease Act of 1941*) did not allow Keynes and his team to achieve anything but a saving of face. The Bretton Woods Agreements, ratified in Washington in 1945, impeded the internationalisation of the creation of liquidity. In substance, they identified the principal regulators of the new structure in fixed currency parities, modifiable only by common agreement in the face of fundamental disequilibria, and in multilateralisation of currency transfer. The freedom of individual States to sustain domestic demand through various instruments, such as the extension of the welfare state, was sheltered from the risk of "capital flight" through a complex and rigorous system of bureaucratic controls over "speculative" movements of capital (in practice all, except direct investments abroad). The creation of international liquidity was entrusted, in fact, to the United States, the only country to have substantial reserves of gold after the war, on the basis of a promise of convertibility of the dollar into gold at a fixed price of 35 dollars an ounce (gold exchange standard). Finally the International Monetary Fund and the International Bank for Reconstruction and Development (the World Bank) were established, but their functions did not reflect those proposed by Keynes: the UN Stabilization Fund and the Bank for Reconstruction and Development,

notwithstanding the terminological maquillage used to hide the rejection of the British design. The system, moreover, included only convertible currencies, issued by a few advanced Western countries. It did not include the countries of the Soviet bloc, nor the rest of the world. It was, however, for the last time, an international monetary system based, at least formally, on an international conference, or on a multilateral basis, and ensured the successful phase of post-war reconstruction and development. The present system results, instead, from successive unilateral decisions.

### The crisis of Bretton Woods

The Bretton Woods structure, having guaranteed the golden years of post-war prosperity, at least for the countries which participated, fell progressively into crisis in the 1960s, when the excessive creation of dollars, consequent also upon the financial needs of the Vietnam war, made the promise of convertibility of the dollar into gold incredible. In 1968, while Europe moved to a customs union and began the process of a common agricultural policy, the double gold market was established, i.e. the United States limited the convertibility of the dollar at 35 dollars an ounce only to central banks holding their official reserves in dollars. In the same year Triffin showed how a country cannot create international liquidity except by accumulating foreign debt to sustain a deficit in its own balance of payments, aimed at the acquisition of goods, services and foreign investments as well as military support of its possessions and the maintenance of influence/complicity in the liberated/occupied countries. He denounced this system as the "international monetary scandal"<sup>1</sup>. In 1971 the United States declared the inconvertibility of the dollar, thus making official the move from gold exchange standard to dollar standard. Exchange rates were left to float according to free market forces, as envisaged by the monetarist school of Milton Friedman. The greatest economists, in fact largely American, abandoned the vulgate of fixed exchange rates for stability and development

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and began to preach that changes in exchange rates would impede the creation of important and persistent disequilibria in the balance of payments. The new world order would be ensured by the market's "invisible hand". Soon, however, it had to be admitted that the market was not so free as they pronounced and the phrase "dirty floating" arrived. The deficit in the US balance of payments was then determined by movements of capital, that is United States investments in the rest of the World. Only from 1982 did the US deficit change nature: the current account balance turned negative and the deficit was financed by attracting savings from the rest of the World not to be reinvested abroad but to finance domestic demand. For almost a quarter of a century this has been the structural situation of the United States, with the result of a frightening growth in its foreign debt.

### European Economic and Monetary Union

The beginning of the extreme phase of dollarisation of the world economy and the launch of the first attempt, in Europe, to avoid a similar fate, occurred at the same time. In 1969, in The Hague, the summit of the heads of state and government of the EEC (European Economic Community) decided to launch a European economic and monetary union, which was to be fully realised, after a long and difficult journey, with the introduction into circulation of the euro, on 1 January 2002<sup>2</sup>.

To support the argument put thus far, it is relevant to remember how the creation of the euro had been preceded by a phase of coupling together the European currencies to a basket made of the same currencies, whereas previously each currency was coupled to the dollar, with the result that the exchange rate volatility of the European currencies (cross-rates) could be greater than the rates between them individually and the dollar. The Economic and Monetary Union, preceded and prepared by the European Monetary System, has preserved *l'acquis communautaire*, which would have been destroyed in a regime of currencies each freely

fluctuating against the dollar; it has put next to the Parliament a second federal institution, the ECB (European Central Bank), in the concrete constitution of Europe; it has modified the expectations of many non-EMU countries, which already constitute a vast area of the euro, and of other countries which look at it with hope; it has allowed a programme of diversification of the official reserves and means of payment by countries such as Russia, China, the Arab oil-producing countries; it has given the example for other regional integrations. The value of the issues of international bonds denominated in euro has already surpassed that of bonds in dollars. On the other hand, consistently with the fact that the European Union has still not realized a common foreign and security policy, the determination of the external value of the euro has in fact been abandoned to the financial markets, even though the Treaty of Maastricht envisaged that exchange rate policy should lie with the economic and finance Ministers (Ecofin, therefore, and not the ECB). Since the degree of openness of exchanges in the euro zone<sup>3</sup> does not exceed 15% and this percentage is reduced in the larger area of the countries which accept the euro, also for payment of supplies of petroleum, gas and raw materials, the problem could seem of little relevance. A problem arises, instead, because the process of globalisation, so far ungoverned, has increased the volume of the international financial transactions to a point where they represent more than sixty times those of world exports and the exchange rates between currencies are determined by the expectations of financial markets rather than the fundamentals of the various economies. These expectations are distorted by the United States to allow them to finance the enormous deficit in the balance of payments from the savings formed in other countries.

**The unpegging of the yuan from the dollar**  
The decision of the Chinese Authorities to unpeg the *yuan* from the dollar, to which it was linked at a fixed exchange rate, and to go instead for a basket of currencies, is not limited, as some

reductive interpretations suggest, to allowing a modest revaluation of the *yuan*. On the announcement of this decision some American banks and some economists suggested that the weight of the dollar in the basket would have remained more than 50%. But the Chinese Authorities soon made known its composition (among the heavier currencies: dollar, euro, *yen* and Korean *won*; among the less important: sterling, Australian dollar, Canadian dollar, Singapore dollar, rouble, Malaysian *ringgit* and Thai *baht*). Although the weight of each currency in the basket has not been communicated, the governor of the People's Bank of China has explained that it depends on trading exchanges. JP Morgan analysts have drawn the conclusion that the weightings should be: 23% yen, 21% dollar, 15% euro, 8% *won*<sup>4</sup>; approximately a third divided among other currencies. This would have to be confirmed by a gradual reduction of the weight of the dollar in the composition of the Chinese currency reserves, by a revaluation of the *yuan* against the dollar and in future by *yuan* convertibility. The new exchange policy adopted by China, like the creation of the euro, reflects the crisis of the international role of the US dollar.

#### For a new Bretton Woods

The gradual acceptance of baskets, such as the *ecu*, the predecessor of the euro; the coupling to a basket of currencies fundamental for world stability, such as the *yuan*; the parallel failure of other attempts to couple only to a single currency of the hegemonic power; all these phenomena indicate the road already begun, that of multilateralisation, to bring the international monetary system up to date with an economy in course of globalisation, multipolar and interdependent.

The intellectual thread for a "new Bretton Woods" is something which unites the *bancor* of Keynes, the special drawing rights of Triffin/Ossola, the European monetary unification and the pressing criticism made by Stiglitz<sup>5</sup> of the catastrophes provoked by the rigid application

of the *Washington Consensus* in situations such as those in South-East Asia, Russia, Argentina (where the dollarisation of the *peso* finished with a serious default of the country and damage to savers throughout the world). However, it is necessary also to take account of the fact that we face, in many ways, a new situation, both because of the extraordinary weight of the problems caused by the unilateral management of the global economy, and because of the complexity and linkage of the challenges for a peaceful and sustainable future. A "new Bretton Woods" ought thus to propose a solution together for the two orders of problem: 1) to consolidate/get over/use the immense foreign debt of the United States and of other debtor countries and introduce a discipline to impede the repetition of fundamental permanent and cumulative disequilibria, like that of the US current account deficit, financed with the savings of the rest of the world; 2) to guarantee the financing of the supply of the necessary public goods for the functioning of a globalised economy, to bring back under control the "World risk society"<sup>6</sup>. For that, in using the ideas, concepts, architectures and instruments in which the thread of Keynes-Triffin-Stiglitz is rich, and referring to the European experience from 1969 to the creation of the euro and its stable and valuable functioning, we must have in mind a global vision, systemic and not only mechanical, ecological and not only economic, insurance and not only banking.

This time the problem cannot be resolved by passing the baton from one hegemonic power to another. We are talking about substituting an ordered system for a disordered order, a multilateral system (a system of systems) for a unilateral order, a cooperative system for a hegemonic order, a global system for a circumscribed order, and an equitable system for an unequal order.

#### A world monetary basket

It is now necessary to move to a world monetary standard: not a gold standard nor a gold-

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exchange standard, not a dollar standard and not even a euro standard, but simply a world standard. The objective is the creation of a world currency, but one can start with a unit of account based on a basket of currencies, a *world currency unit (wcu)*<sup>7</sup>. The weight of the various currencies in the basket would have to be set out in the agreements according to a valuation of each based on economic fundamentals which also include elements which are not today counted as economic, such as human development, ecological sustainability, the concentration / diffusion of assets and incomes, the demographic composition of the population and their tendencies. Since the measurement of these values is today still rough and can lead to discussions, a procedure would have to be designed to revise the agreement to modify the weights. In future, when reliable and shared measurements are available, the revisions could become automatic. The wcu has no need for coupling. It expresses a productive potential socially and ecologically compatible and a promise of payment in terms of goods and services which constitute world wealth redefined as above.

All currencies should have the possibility of joining the system. Among the participating currencies, some already represent regional monetary systems and also wider areas (dollar, euro, *yen, yuan, rouble*) others ought to be encouraged to form regional groups, within which to regulate the major part of their transactions and questions. In any case the value of every currency, whether as the expression of a system or a simple national currency, would be defined in terms of wcu in the initial agreements.

The markets would thus have at their disposal a powerful indicator to define the exchange rates among the different currencies, with the probable result of a substantial reduction in their volatility. Furthermore, certain goods particularly important in the world market, such as for example the barrel of petroleum, could be

quoted in wcu with a stabilising effect on prices, to represent the relationship between supply and demand without the effect of expectations in currency markets, a result which would not be obtained by substituting the quotation in dollars with any other currency. The move from quotation in wcu to payment in wcu could be swift since it would correspond, in the most effective and equitable manner, to the unsatisfied need for diversification in portfolios. Finally, the association of the unit of world measure of value with the value of non-renewable energy would provide a universal educational function.

The functioning of multilateral clearing, the concession of overdrafts to cover temporary disequilibria (excluding long-term support for poor countries and other projects, entrusted to the World Bank), the sterilisation of speculative attacks on a currency, ought to be governed by the agreements and use well tested instruments such as clearing unions, special drawing rights, cooperation and monetary stabilization funds, adapted however to the new objectives of harmonic development and made consistent with the weights recognised in every economy / system.

### Consolidation of the US foreign debt and right of world seigniorage

Every central bank in the system, holding official reserves denominated in currencies issued by other central banks, would have to be able to ask for the conversion, total or partial, in wcu. At the moment of distribution of wcu, a premium ought to be levied according to a share fixed in the agreements and could be modified with their revision. It would be a real and proper right of world seigniorage, as transparent in drawdown as in the destination of funds: to give the UN its own resources, to finance the functioning of the system, to capitalize the related institutions, such as the World Bank, which could then access the market, within fixed leverage-ratios, to multiply the financial resources needed for its assigned aims. It may be observed that, differently from the Tobin Tax, this premium

would be applied only to transactions between central banks, without "disturbing" the capital markets. It would in fact consist of an insurance premium, it would cost the world much less than the right of seigniorage which the United States today enjoys and would allow the financing of a system much more effective and efficient in supplying public goods and risk management at a global level.

**The reform of the world economic institutions**  
We should have to configure a real and proper *World Monetary Systems' Organization* operating as a system of systems for the regional currencies and as a supplementary system for the currencies not yet participating in the regional systems.

The supervision of the new organization ought to be entrusted to the IMF, to be recognised as a real and proper Council of Economic Ministers of the UN (similar to Ecofin for the EU), as already proposed by Jacques Delors. The management of the new organization ought instead to be entrusted to the Bank for International Settlements (together with the collection of the conversion rate which the BIS will pass to the IMF for division among the final recipients).

Naturally, the IMF will have to be reformed to represent as democratically as possible the major regional monetary areas. It will have

to be governed, cooperatively, by qualified majority voting based on the weight of the participants and present annual report to the UN General Assembly, in the context of a more general democratic strengthening of the UN itself<sup>8</sup>.

The institutional architecture should be completed with the reform of another institution already in existence, the World Bank, and the creation of two new organisms: an Institute to manage risk and a Control Commission. The World Bank would be a specialised Agency of the IMF (and through it of the UN) for the financing of projects directed to promote security, human development and environmental and social sustainability of the globalised economy. The Bank would thus become the principal financial support for human development and could justify a change of name to *Human Development Bank*. The IMF ought also to institute a new agency (*World Risk Management Institute*) for the evaluation and management of global risks<sup>9</sup>, such as economic, the financial crises and the physical and social global threats, which individual States uselessly attempt to confront with the logic of sovereignty. Finally, for the control of the markets and their controllers, a *World Financial Control Commission* should be established.

<sup>1</sup>Robert Triffin, *Our International Monetary System: Yesterday, Today and Tomorrow*, New York, Random House, 1968.

<sup>2</sup>For a history of the passage from the Werner Plan to the creation of the euro:

Tommaso Padoa-Schioppa, *La lunga via per l'euro*, Bologna, Il Mulino, 2004

Matt Marshall, *The Bank*, London, Random House, 1999.

<sup>3</sup>The degree of openness results from the ratio of the sum of import and exports of goods and services with external countries (in this case the 12 EMU countries) and their GDP.

<sup>4</sup>Riccardo Sorrentino, *Avanza la liberalizzazione dello yuan*, in *Il Sole-24 Ore*, 11 August 2005.

<sup>5</sup>Joseph E. Stiglitz, *Globalization and Its Discontents*, Torino, Einaudi, 2002.

<sup>6</sup>Ulrich Beck, *The terrorist threat. World risk society revisited* in *Theory, Culture and Society*, XIX, 2002, no. 4, pp. 39-55. According to Beck we are entering a world of uncontrollable risk (a contradiction in terms), composed of uncertainties and unnatural dangers, created by man. The prospect we adopt discounts the possibility (the duty) of a control of global risks.

<sup>7</sup>One could think of *Sdrs* evolving into *Wcu* as happened with the *ecu*.

<sup>8</sup>Among the many UN reform projects, we are referring to the federalist one proposed by Lucio Levi in *Crisi dello Stato e governo del mondo*, Torino, Giappichelli Editore, 2005, Cap. 9 - *L'unificazione del mondo come progetto e come processo*, pp. 295-335.

<sup>9</sup>For the description of possible innovative approaches to the management of these risks, entrusted to the financial markets with the support of nation states, see Robert J. Shiller, *The New Financial Order*, New Jersey, Princeton, 2003. The prospect we adopt is based instead on the conviction that an approach to global risks requires the establishment of an institution of corresponding level to direct the markets.