Reforming the Global Reserve System
By Jane D'Arista

President Nixon's decision to end the Bretton Woods agreement in 1971 ushered in a new international monetary system – one in which international payments in dollars would be made by private banks rather than exchanges of gold between the Federal Reserve and other central banks, and the value of the dollar would be determined by supply and demand. This new dollar-centric international monetary system has been a powerful force in shaping the global economy and is, to a great extent, responsible for the current pattern of globalization.

For example, maintaining dollar hegemony meant that U.S. policy-makers had to hold real U.S. interest rates higher than those of other strong currencies and accept a higher value of the dollar relative to other major currencies. This made U.S. goods less competitive than those of other economies and resulted in the loss of export markets, the loss of markets at home and the loss of well-paid jobs in the tradable-goods sector of the economy.

For developing countries, the consequences have been no less serious. The post-Bretton Woods system has pushed more and more economies toward export-led growth, which tends to suppress domestic wages and regulatory standards. Countries that cannot pay for imports and attract foreign investment in their own currencies must "earn" strong currencies, mainly dollars, by exporting more than they import to one or a few countries that issue the global means of payment. To remain competitive with other nations and insure continued access to these markets, they have adopted policies that maintain downward pressure on wages and exchange rates and have shunned those that stimulate the level of domestic demand necessary for sustained development.

The export-led growth paradigm created by the current international monetary system appeared to have benefited the United States, the key currency country, by enabling it to consume more than it produced. A large share of the dollars that flowed out of the United States to pay for imports flowed back as investments in U.S. financial assets. This foreign investment expanded credit and allowed Americans to spend more and save less. It also made many Americans feel wealthier than they actually were by fueling inflated equity and real estate prices. But the cost of this pattern of growth was the rapid buildup of both domestic and external debt. Over the last decade, the rising level of household debt relative to disposable income signaled that dependence on debt-fueled growth was as unsustainable for the United States as for any other country and would, as it has, result in recession.

To build a new global economic order, the underlying logic of the international financial system must be radically altered. What is needed is a new international monetary regime that can open access to international trade and investment for all nations on equal terms by allowing all currencies to be used in cross-border as well as domestic transactions. John Maynard Keynes' international clearing agency could serve as a basic structure for such a system, reclaiming the public sector's role in global payments through a process of debiting and crediting cross-border payments against reserve accounts held with the clearing agency by member countries and with changes in reserves used to determine periodic adjustments in exchange rates.

An international monetary system based on the idea of an international clearing agency could also be designed to create a truly global lender-of-last-resort, replacing the current ad hoc facilities which depend on taxpayer donations. With approval of a governing board whose membership would at all times represent half the world's population and half its wealth, the agency could engage in open market operations as proposed by Harry Dexter White, buying and selling the government securities of member countries to increase or reduce their reserve balances. This would provide an effective channel for containing damaging financial crises and maintaining the financial stability needed for balanced growth in the global economy. It would also permit the resumption of demand-led growth policies that are a necessary support for a new, global social contract.

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For a complete version of this paper, see "Reforming the Privatized international Monetary and Financial Architecture", Challenge, May-June, 2000, 43 (3), 44-82.