THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM: A FORK IN THE ROAD

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San Francisco years (as remembered in Golden Gate Park)

Crockett’s three components of an IMFS (2010)

- The underlying economic framework for international monetary and financial relations
- The institutional arrangements under which those relations are conducted
- The distribution of governing power in the system

The system has evolved.

But the foundational idea that trade facilitates mutual prosperity has been a constant driver over eighty years -- up until 2025

A grievance narrative drives US geoeconomic policy

- Unfair global trade, which causes US trade deficits and manufacturing decline

- Unfair global capital markets, which take advantage of using the dollar and accessing US financial markets

- Unfair burdens of expensive foreign security commitments (broadly defined)

The basic concerns are not new; the zero-sum approach to redress them is

Bretton Woods, 1945-1973

- Underlying economic framework
  - From inconvertibility to current account convertibility
  - Gradual trade liberalization
  - Fixed but adjustable exchange rates
- Institutional arrangements
  - IMF, WB, GATT
  - Government-led system with substantial state intervention in economy
  - Increasing central bank cooperation to shore up the system
  - Extensive US security umbrella for "free world"
- Distribution of power
  - US hegemony – but important US provision of public goods
  - US "exorbitant privilege" with respect to monetary policy, b.o.p. deficits
  - Power concentrated in industrial economies/ongoing transition from colonialism

Mentioned 18 times in the Fund's initial Articles, the dollar was bound to rule the postwar IMFS

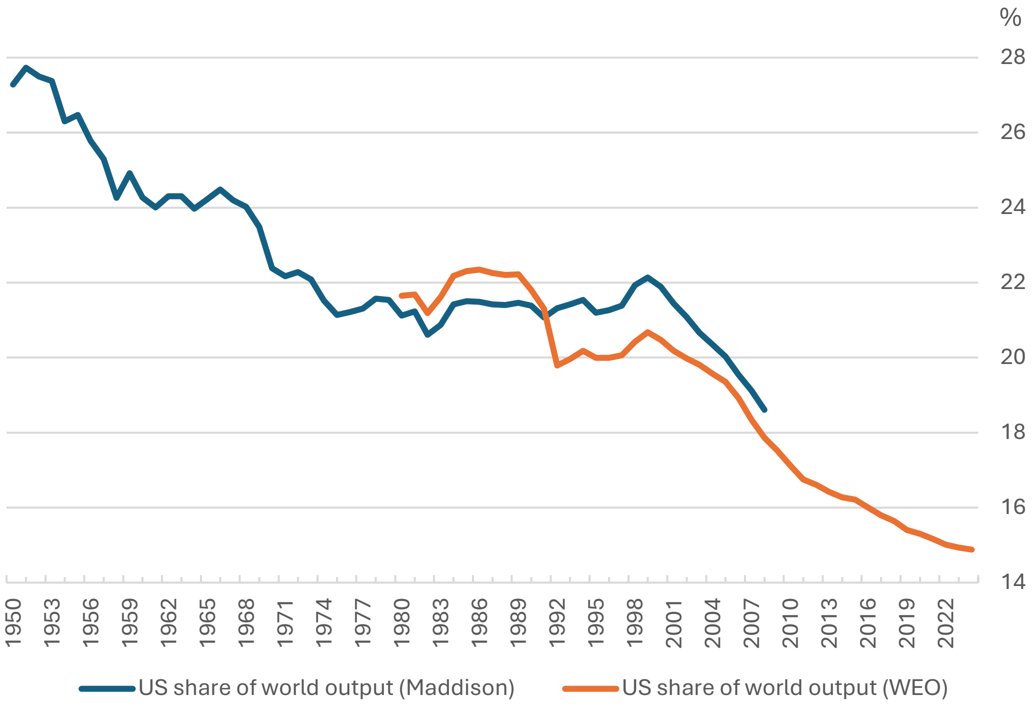


Figure 1

US share of world GDP at purchasing power parity, 1947-2024.

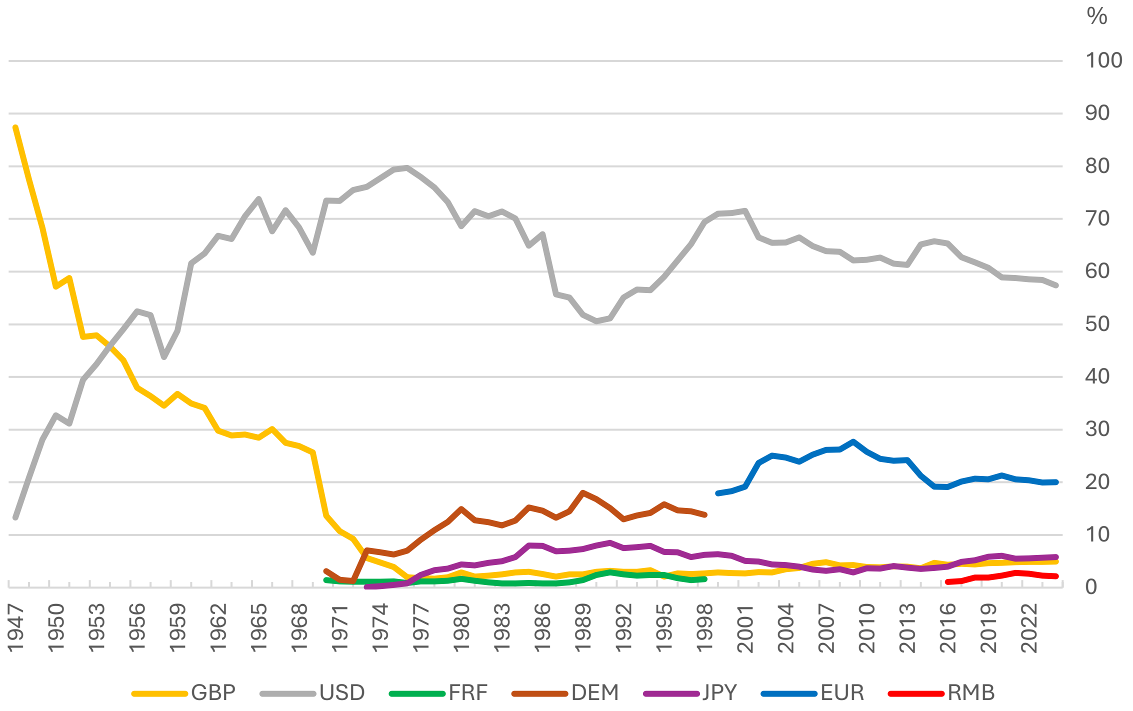


Figure 2

Major currencies' shares in global foreign currency reserves, 1947-2024

Even during Bretton Woods, the US pressured allies and faced tradeoffs in its global role

- Eisenhower and Suez
- JFK February 1961 address to Congress on gold
- Trilateral negotiations and Blessing-Martin letter of 1967
- Nixon's Guam Doctrine of 1969
- The Nixon shock of 1971 → floating exchange rates in 1973

Change during the 1970s

- Very high inflation
- US capital account liberalization in January 1974 – partly intended to weaken the dollar
- Resulting integration of onshore and offshore dollar markets
- OPEC finds its power
- Substitution Account proposal
- Start of BCBS process via the BIS

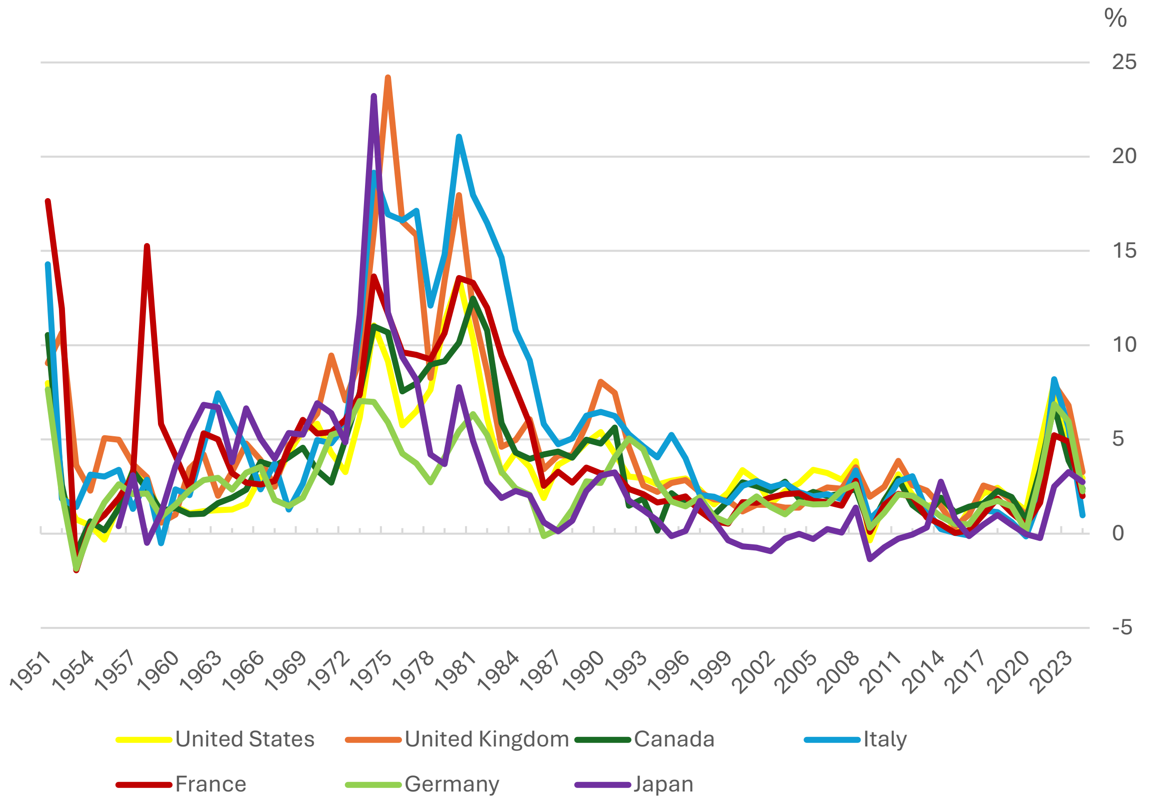


Figure 3

Inflation rates for G7 countries, 1951-2024.

Transition during the 1980s

- Volcker tamed inflation
- Upsides for the dollar from Reagan's fiscal deficits
- US an example of increasing financial liberalization and market-orientation that spreads worldwide (including to China)
- Strong US commitment to markets and rule of law set the stage for a resurgence of dollar dominance in the 1990s
- End of Cold War set the stage for hyper-globalization starting in the 1990s

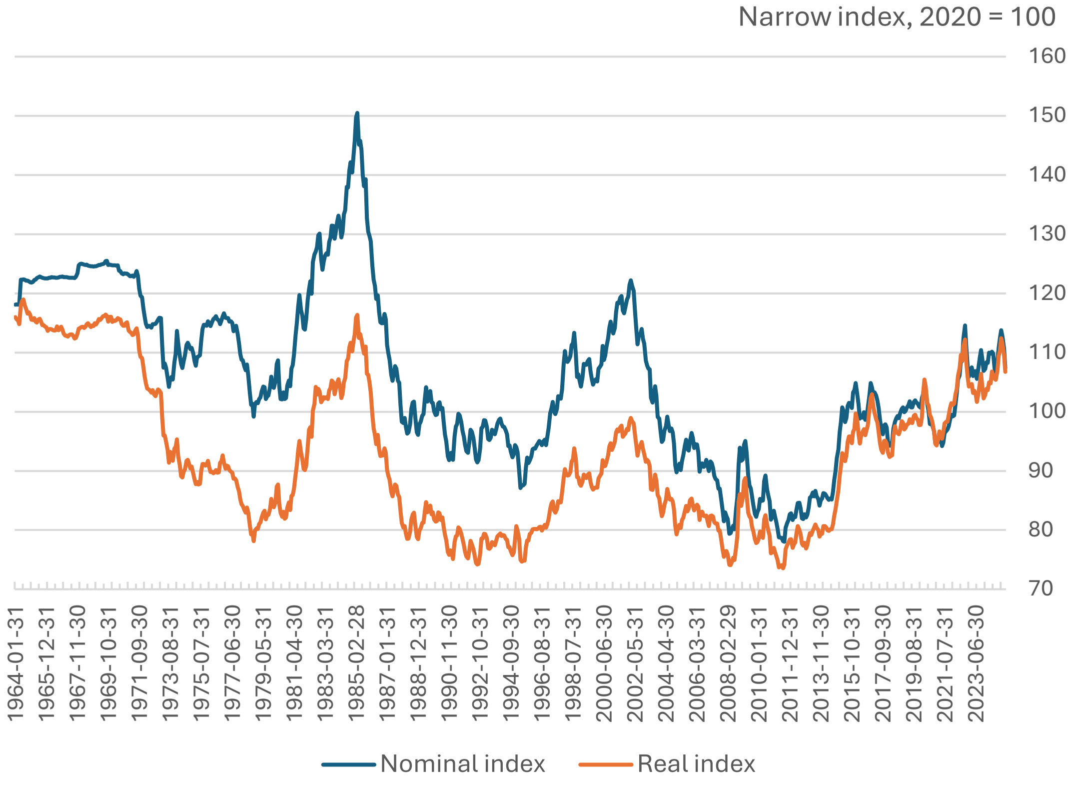


Figure 4

Nominal and real effective exchange rate indexes for the US dollar, 1964-2025.

1990s: Dollar’s role solidified

- New economic framework
  - After the 1980s, the dollar became more central than ever
  - Hyper-globalization: growth of capital markets, trade, supply chains
  - Enthusiastic EMDE participation that drives considerable convergence
  - World peace and the mode of globalization -- courting later troubles?
- New institutional structures
  - WTO
  - Expanded country participation in Basel processes (favored by Crockett)
  - FSF (initially chaired by Crockett)
  - More regularized multilateral consultation
  - Maturing IMF role in capital-account crises
- New power distribution
  - US is the sole hegemon, but everyone cashes in on “peace dividend”
  - EM influence grows and former Soviet bloc enters world economy
  - EC raises its game through Maastricht Treaty and the euro: but dollar still reigns

The eventful past 25 years have brought more evolution in institutions and the distribution of power ...

- ... as well as internal tensions, not all due to economics, and which it is not my comparative advantage to analyze or summarize!
- Among institutional changes (many but not all not all positive):
  - G20 process
  - Extended swap lines and other regional initiatives
  - FSB, Basel III
  - Degradation of WTO
- Among power changes:
  - Rise of China – and declining US hegemony, more US ambivalence in supplying global public goods
  - Internal political developments have changed external behavioral norms, changing the power balance and the way power is exercised

Widespread adoption of inflation targeting and CBI yielded key institutional and power changes

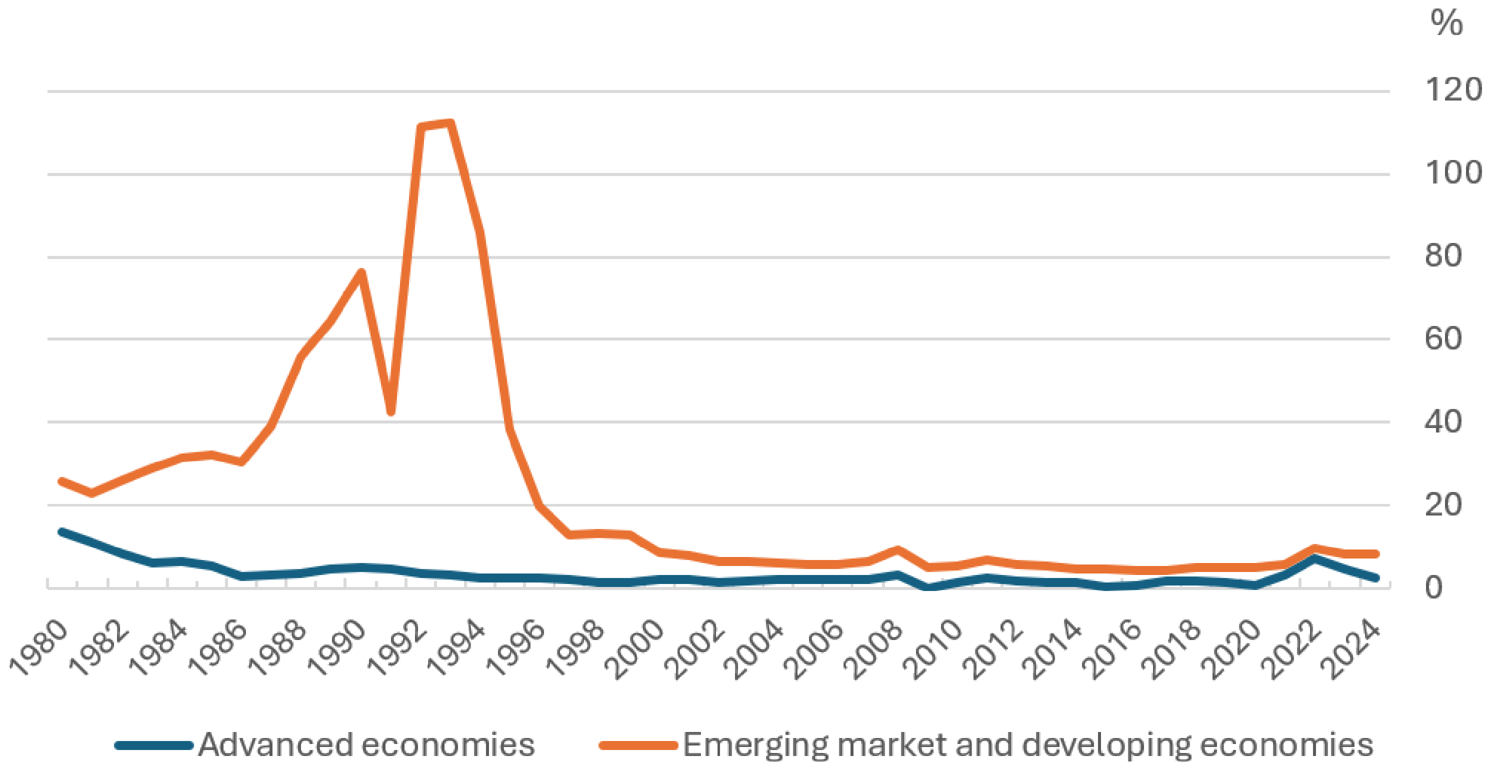


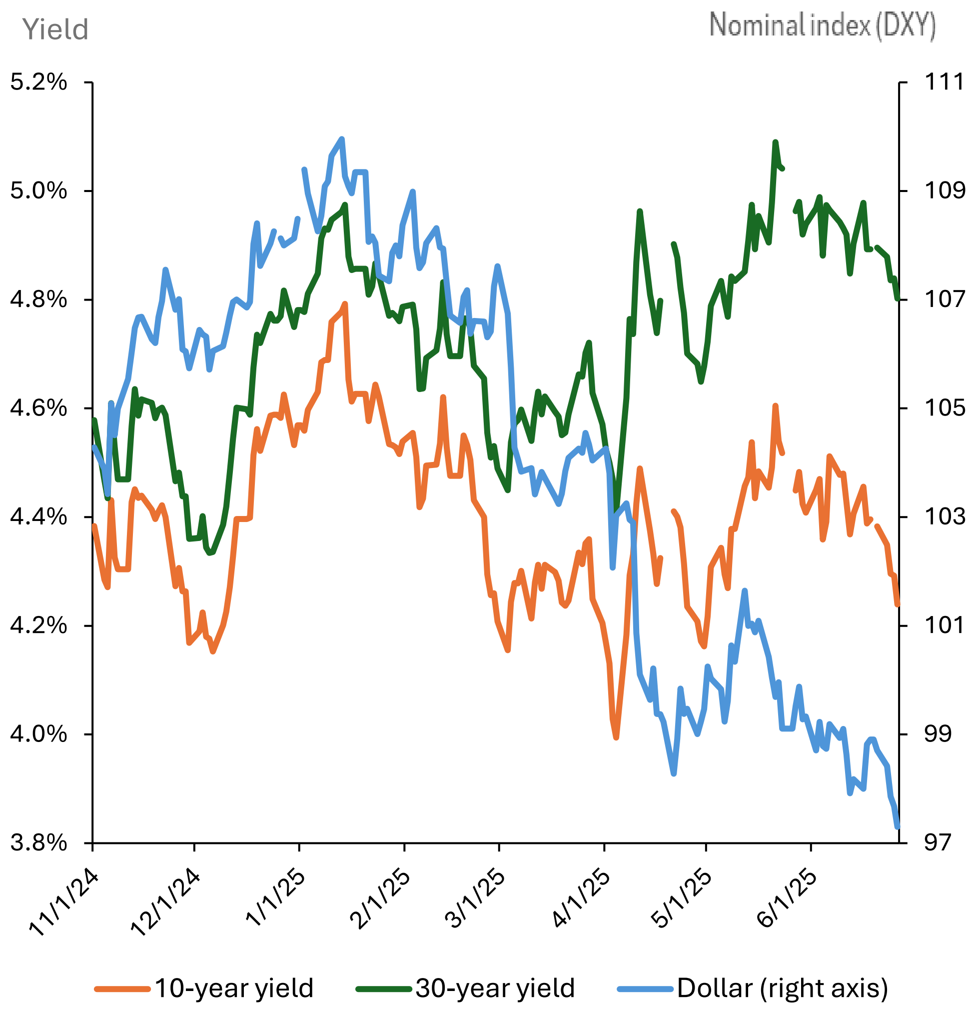
Figure 5

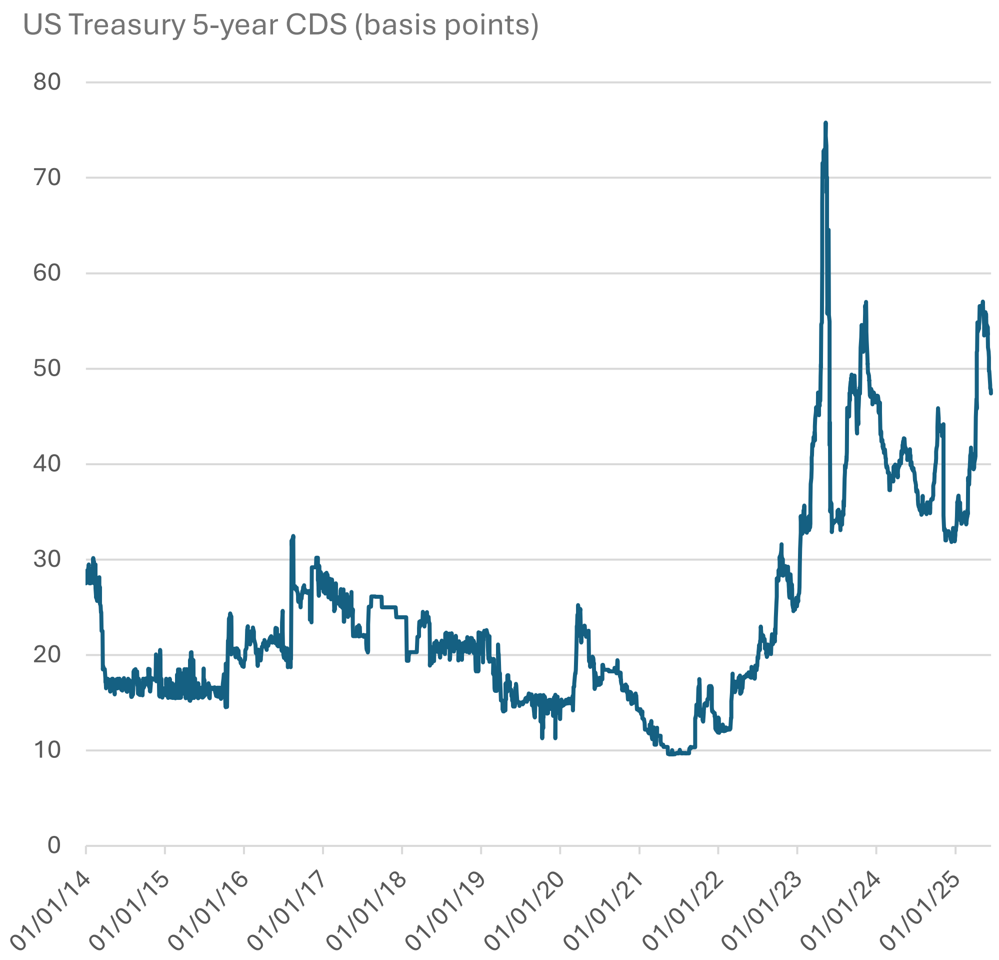
Annual inflation in advanced and emerging market and developing economies.

The IMFS is now at a fork in the road

- The dollar's global role is a handy prism on fragmentation risks
- Trump administration policies threaten to undermine the dollar's advantages and fragment global markets
  - Countries will want to insulate themselves from economic coercion → less integration with the United States
  - Tariffs that reduce US trade will diminish the dollar
  - Pressure on the Fed
    - Including enhanced executive oversight of financial regulatory function through OIRA
  - Pullback from international regulatory cooperation?
  - Conditionality or absence of swap lines
  - Fiscal incontinence and risk of fiscal dominance
  - Risk of US capital controls (inflow and outflow)
  - Looser enforcement of rules on money laundering, bribery, etc.
  - GENIUS Act and politically- (and fiscally-) motivated worldwide promotion of dollar stablecoins
  - Fragmentation of cross-border payments system
  - US retreat from providing key global security public goods (military and others)
- Changes in Treasury risk premia may impair safe-haven quality of US obligations

Worrisome market developments …





… amid wide-ranging incursions on US institutions

- Alexander Hamilton wrote in his *Report Relative to a Provision for the Support of Public Credit* (January 1790):

    > States, like individuals, who observe their engagements, are respected and trusted: while the reverse is the fate of those, who pursue an opposite conduct.

- The US has aspired to this standard (if imperfectly in practice) and its institutional anchors have been fashioned toward this ideal
- But as Andrew Crockett observed in 2000:

    > [A]nchors are no better than the ground in which they are planted. And that ground could, at worst, turn out to be quicksand.

Without a US about-face, where are we headed?

- Economic framework
  - Segmentation in trade and finance between US and rest of world
  - US abandonment of MFN principle and non-discrimination
  - Possible inflationary/fiscal instability in the US – lower long-term growth
  - How this spills over abroad depends on ability of others to cooperate
- Institutions
  - These may have to evolve through “coalitions of the willing”
  - The current structure of IFIs may not be sustainable
- Power
  - The US will have less power in the system – not just “soft,” but “hard”
  - Its influence will be greater the more disunited is the rest of the world
  - Europe has the potential to raise its influence significantly
  - Unity, even if the US demurs, is imperative in a more fragile and connected world

Thank you.