The Case for a New International Monetary System

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How often do we hear references to the notion that we live in a rules-based global trading system? Addressing the World Economic Forum at Davos in January 2017, British Prime Minister Theresa May praised liberalism, free trade, and globalization as "the forces that underpin the rules-based international system that is key to our global prosperity and security" (Martin 2017). Chinese President Xi Jinping likewise extolled the virtues of a rules-based economic order at Davos, winning widespread praise for defending free trade and globalization (Fidler, Chen, and Wei 2017).

But could someone please explain: What exactly are those rules? Because if we are going to invoke the sentimentality of Bretton Woods by suggesting that the world has remained true to its precepts, we are ignoring geopolitical reality. Moreover, we are denying the warped economic consequences of global trade conducted in the absence of orderly currency arrangements. We have not had a rules-based international monetary system since President Nixon ended the Bretton Woods agreement in August 1971. Today there are compelling reasons—political, economic, and strategic—for President Trump to initiate the establishment of a new international monetary system.

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An Inspiring Vision of Future Prosperity

To fully appreciate how far we have strayed from the high-minded objectives that motivated the 1944 multilateral currency accord forged at Bretton Woods, New Hampshire, it's useful to reflect on the fundamental principles that defined its purpose and to consider the historical context for its acceptance.

The United States had been attacked at Pearl Harbor scarcely a week before Treasury Secretary Henry Morgenthau asked his deputy, Harry Dexter White, to prepare a paper outlining the possibilities for coordinated monetary arrangements among the United States and its allies. The primary goal was to provide the means, the instrument, and the procedure to stabilize foreign exchange rates and strengthen the internal monetary systems of the Allied countries (Horsefield 1969a: 12).

Why was it deemed so important to ensure stable exchange rates at a time of war when the very survival of Allied nations was at stake? The answer: struggling nations required assurances that a more prosperous economic future was in store if they could summon the will to prevail over Axis powers. During the 1930s, countries had engaged in competitive devaluations to gain an export advantage over their trade partners. As the gold standard was serially abandoned, international trade succumbed to the vicissitudes of unpredictable changes in exchange rates and retaliatory tariffs. Global depression had followed.

But now the United States was suggesting that something new would be done in the sphere of international economic relations—something "powerful enough and comprehensive enough to give expectation of successfully filling a world need" (White 1942, in Horsefield 1969b: 46). By establishing new rules to ensure a level monetary playing field as the logical foundation for expanded free trade and the optimal use of financial capital, America would be providing those needed assurances that would "unify and encourage the anti-Axis forces, to greatly strengthen their will and effort to win" (ibid., pp. 38–39).

Did it work? Less than four weeks after Allied forces landed at Normandy on June 6, 1944, the Bretton Woods conference was convened. Representatives from 44 Allied nations hammered out rules for participating in an international monetary system based on fixed exchange rates anchored by a U.S. dollar convertible into gold. The Axis powers surrendered the following year.

Did adoption of a stable monetary platform deliver as promised? The Bretton Woods era would be characterized by remarkable economic growth rates, extraordinary productivity gains, and decreased inequality of wealth.

Losing the Dream

The period of exceptional world economic performance was ended in 1971. Some blame the closing of the gold window on American domestic budget exigencies. Others attribute the collapse of Bretton Woods to the "Triffin dilemma"—a failing inherent in its dependence on a single reserve currency country. In any case, the vision of providing a solid monetary foundation for global free trade was shattered by Nixon's decision to suspend gold convertibility of the dollar.

Paul Volcker, serving as undersecretary for monetary affairs at the Treasury department, felt anguished at the time. He was concerned that the initiative would be seen as a humiliating change in U.S. domestic policy and a derogation of duty in the international monetary arena (Volcker and Gyohten 1992: 78–79). Volcker had advised Nixon to make the move as a temporary decision to redress the flaws of Bretton Woods. Nixon himself had told the American people in his televised speech on August 15: "We will press for the necessary reforms to set up an urgently needed new international monetary system" (Nixon 1971).

But a novel theory was being promoted by members of the emerging group of monetarist economists associated with the Chicago School—led by Milton Friedman—arguing that floating exchange rates were preferable to the fixed-rate Bretton Woods system. Keynesians quickly seized the opportunity to pursue fiscal activism without the constraints imposed by balanced budgets and the discipline of gold convertibility.

The new approach that emerged in the vacuum left by the dissolution of Bretton Woods was to have *no* international monetary system—that is, no rules or coherent mechanism for maintaining exchange-rate stability among national currencies.

The free-for-all approach to determining exchange rates is sometimes promoted as a "free market" solution. However, if exchange rates are truly determined by market forces alone—not subject to government intervention or manipulation—why are governments

allowed to build up massive foreign currency reserves? Theoretically, the exchange rate between a nation's currency and other currencies should be determined at any given moment by the forces of demand and supply. Instead, governments not only accumulate reserves as a bulwark for thwarting market forces, but also use monetary policy to deliberately manipulate their currencies to gain an advantage over trade partners.

The currency disorder that reigns today is anathema to any notion of free and fair trade. Nations can blatantly target the exchange rate they desire—in pursuit of strategic objectives. Deliberate depreciation is used to boost exports; it's the customary definition of currency manipulation. However, financial capital flows may figure more importantly for some nations, in which case they may instead choose to manipulate their currencies upward to attract foreign investment. Deliberate appreciation also enables a nation to maximize the purchasing power of its currency for purposes of obtaining strategically important assets abroad.

Central banks play a major role in either case. They are the main players when it comes to currency manipulation, even when monetary officials claim that the exchange rate consequences of their policies are merely incidental to achieving domestic economic objectives.

The lack of any kind of rules-based monetary system to uphold the legitimacy of global free trade is provoking economic tensions among powerful nations. It is fueling the fundamental dissonance between monetary policy and the credit demands of the real economy.

In short, we have the worst of all worlds in the currency arena. It should not require the threat of war this time to spur an American initiative for international monetary reform.

The Imperative of U.S. Leadership

Just as the United States rose to the challenge of providing inspiration to desperate nations with a promise to establish stable and trustworthy monetary rules to undergird international commerce in compliance with free trade principles, the needed initiative falls once again to America. And just as then, the advantages of a sound money approach to ensure a level playing field that maximizes the rewards from true competition—by preventing currency manipulation through government intervention—will serve our own best interests.

It's a pivotal moment. The challenge these days is to inspire struggling nations to continue to believe in the advantages of democratic capitalism, to embrace free market ideas and support entrepreneurial endeavor. The United States is the only country that can meaningfully address the status quo disarray in monetary arrangements. According to Jacques de Larosiere (2014), former managing director of the International Monetary Fund, what we have today amounts to an "anti-system."

The current monetary regime permits governments to knowingly distort exchange rates under the guise of national monetary autonomy while paying lip service to avoiding trade protectionism. It empowers central banks to channel the benefits of monetary policy decisions to some people at the expense of others, pitting wealthy investors against average savers. It facilitates cheap government borrowing. The shift toward increasing government influence over economic outcomes is anathema to the free market doctrines propounded by Friedman.

If the United States does nothing to restore a rules-based approach to international monetary relations, our values come into question. We lose credibility by failing to challenge an international monetary anti-system that condones cheating by governments and central banks. We acquiesce to the fiction that enforceable rules exist to ensure against currency manipulation—even as we complain about trade imbalances contrived through exchange-rate targeting.

Dangerously, we pretend that today's speculative gaming in foreign exchange markets by the world's largest banks somehow validates the casino of floating rates—as if the $5.1 trillion daily turnover does not vastly exceed the amounts necessary to finance international trade and finance. The U.S. dollar is involved in 88 percent of the trades (BIS 2016: 3) in a currency market exhibiting "rising instances of volatility outbursts and flash events" (Murphy 2016).

Preemptive International Monetary Reform

America has long had the luxury of issuing the world's most dominant currency without having to guarantee its integrity. But with the dollar's popularity come financial risks: Widespread use of our nation's money for structuring complex derivatives, or for denominating debt to foreign borrowers, sets up America's economy for unanticipated repercussions. Financial fallout from regional defaults

triggered by a surge in the value of the dollar against other currencies would impact bank and nonbank institutions, and in turn constrain the availability of credit to domestic borrowers.

More concerning is the exposure to a broader global financial crisis brought on by liquidity pressures in the foreign exchange market due to the sheer volume of dollar-denominated currency swaps and related contracts. Staggering levels of such instruments—some $58 trillion, according to the Bank for International Settlements—are not recorded on balance sheets even though they function as debt-like obligations (Borio, McCauley, and McGuire 2017).

President Trump has demonstrated his resolve to meaningfully address the problems caused by currency disorder. Early in his campaign he called attention to the unfairness of currency manipulation by governments. He defined himself as a "free trader" while nevertheless insisting that trade had to be conducted on a level playing field. He denounced currency depreciation as cheating and vowed to punish offenders for "stealing" American manufacturing jobs (Holland and Lawder 2017).

Now he has an opportunity to restructure existing international monetary arrangements—to implement a rules-based approach—through decisive action.

The political imperative for President Trump derives from both his criticism of domestic monetary policy and his identification of currency manipulation as a violation of free trade principles. As a candidate, he acknowledged that the extraordinarily low interest rates of accommodative monetary policy were punitive for ordinary savers—they were "getting creamed"—even as developers such as himself had access to extremely low-cost funding from banks (Davidson and Taylor 2016). As an experienced businessman, Trump also expressed disapproval of the Federal Reserve for fueling "a big fat ugly bubble" in financial markets through low interest rates (Crutsinger 2017).

On the international front, besides identifying the distorting impact on trade and economic performance caused by currency manipulation, Trump has publicly expressed concern over whether government policies were supportive of the dollar as a trustworthy currency and reliable measure of value. In September 2011 he accepted gold bars in lieu of payment in dollars as a security deposit on commercial space in one of his properties, publicly stating: "Obama's not protecting the dollar at all." Trump has expressed positive views on the gold standard, noting during a 2015 televised

town hall that there was something "solid" about the United States when its currency was linked to gold—though he conceded that restoring it would be difficult (McElveen 2015).

Still, when asked by *GQ* magazine to give his spontaneous reaction to the notion of a gold standard, Trump responded: "Bringing back the gold standard would be very hard to do, but boy, would it be wonderful. We'd have a standard on which to base our money."[1]

Trump's views on monetary policy and his concern for the integrity of the dollar clearly resonated with American voters; accusations that he was "politicizing" the Fed by criticizing the negative aspects of low rates did not seem to hurt his political popularity, nor did the usual "goldbug" epithets. Economic forces had combined with social tensions in the aftermath of the 2008 financial crisis to incite people on both the right and the left over the perception that a "rigged" system had bailed out the perpetrators at their expense. From the Tea Party movement to Occupy Wall Street, long-simmering grievances over economic inequities came to a head in the 2016 election.

President Trump's economic imperative now is to initiate reform both at the Federal Reserve and in conjunction with the international community to redefine monetary relations. The extraordinary measures of accommodative interest rate policy enacted by the Fed over an extended period have exacerbated income inequality, an issue to which Federal Reserve Governor Lael Brainard recently alluded (Torry 2017). The task for the next Fed chairman to be nominated by Trump is to craft an interest rate glide path that will soothe markets while supporting a pro-growth economic agenda. At the same time, given that economic and financial outcomes are highly vulnerable to currency shifts, such finesse in formulating monetary policy must include direct consideration of the dollar's value relative to other currencies.

What's needed is a comprehensive approach for linking the money supply to increases in productive output—the restoration of sound money principles for economic growth. It's time to reassert the primary functions of money as (1) a medium of exchange, (2) a unit of account, and (3) a store of value. Workers hurt by the consequences

[1]See the GQ website at https://thescene.com/watch/gq/donald-trump-weighs-in-on-marijuana-hillary-clinton-and-man-buns?mbid=marketing_paid_cne_social_facebook_scene_gq_dp_28.

of the 2008 financial market meltdown need to be assured that they will not be punished by a future bubble; no more monetary favoritism. It is also imperative that global monetary turmoil not undermine what currently passes for economic recovery.

Ultimately, the compelling reason for the Trump administration to undertake the challenge of structuring a new international monetary system is that democratic capitalism is unlikely to survive another blow on the scale of what has been endured this past decade. And having been so critical of currency manipulation and its deleterious impact on trade flows, it is incumbent on President Trump to propose what would constitute a better approach to exchange rate relations. The United States cannot point an accusing finger without defining the ameliorating change in behavior—or better yet, the set of new rules—it would require trade partners to accept.

The role of the dollar as the world's dominant reserve currency is a matter of national strategic importance: it is the strongest tool in our soft power arsenal. Yet the dollar's vulnerability to uncontrollable developments in foreign exchange markets is a potential weakness; it could perversely become a deterrent to effective domestic monetary policy. It would be negligent to permit currency shifts to undermine the hard-sought growth benefits of tax and trade reform.

Thus it falls to the United States under President Trump to champion the noble cause of restoring order to international monetary relations—so that free trade does not fall victim to the demoralizing effects of having economic and financial outcomes altered through exchange rate machinations.

Playing to Our Strengths

Proposing a new approach in keeping with the Trump administration's emerging national security strategy doctrine, which emphasizes the primacy of national sovereignty, engages our strong suit of financial supremacy to good purpose in the international economic arena.

Timing is important to ensure that a future monetary system is not governed by a global body; such a development would be distinctly at odds with Trump administration objectives. The International Monetary Fund long ago abandoned its responsibility for maintaining a stable international exchange rate system anchored by a gold-convertible dollar. Yet today it flirts with the notion of serving as the main platform for regulating cryptocurrencies. Citing the

organization's "mandate for economic and financial stability" as rationale, IMF Managing Director Christine Lagarde (2017) proposed recently that the IMF take a strong role in overseeing the advent of virtual currencies and also move forward toward creating a digital version of the SDR.

Such a bold move to assert control over monetary policy at the global level would constitute a challenge to the continued reign of the U.S. dollar and undermine our own nation's sovereign power and influence in global financial markets. America needs to have a better idea—one that readily accommodates and creatively uses evolving advances in fintech capabilities.

If the appeal of cryptocurrencies is their capacity to provide a common currency, and to maintain a uniform value for every issued unit, we need only consult historical experience to ascertain that these same qualities were achieved through the classical international gold standard without sacrificing the sovereignty of individual nations. To the contrary: gold standard rules permit nations to participate voluntarily by operating in accordance with the discipline of gold convertibility of their own currencies.

A modern version of this approach—one that permits the issuance of virtual currencies in tandem with government-issued currencies, adapting legal tender laws to permit healthy currency competition—should be put forward.

Golden Opportunity

The United States is the world's largest holder of official gold reserves. Comprising 8,311.5 tonnes or 261 million troy ounces, those reserves are carried at a book value of roughly $11 billion. Notably, the market value is significantly higher at $345 billion (based on the London Gold Fixing for September 30, 2016) as cited in the Treasury's report filed June 30, 2017 (U.S. Department of the Treasury 2017).

In proposing a new international monetary system linked in some way to gold, America has an opportunity to secure continued prominence in global monetary affairs while also promoting genuine free trade based on a solid monetary foundation. Gold has historically provided a common denominator for measuring value; widely accepted at all income levels of society, it is universally acknowledged as a monetary surrogate with intrinsic value.

Speaking in February 2017, former Federal Reserve Chairman Alan Greenspan defined gold as the "primary global currency" and further added, "We would never have reached this position of extreme indebtedness were we on the gold standard, because the gold standard is a way of ensuring that fiscal policy never gets out of line" (Oyedele 2017). To confront U.S. indebtedness, we need to restore fiscal discipline and sound money through gold convertibility.

We make America great again by making America's money great again.

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