Updating the International Financial and Monetary System – IMF – G20 Finance Working Group

Various parts of the world are facing economic jitters over concerns about large Bank failures. The Bretton Woods Conference commemorates its 80 th Anniversary in 2024. Is it time for a significant overhaul? Also, the IMF's Special Drawing Rights (SDRs) appear to be replacing the dollar as a reserve currency for a growing number of countries for both political and well as economic/financial reasons. How should this be managed?

Background & Historical Reference:

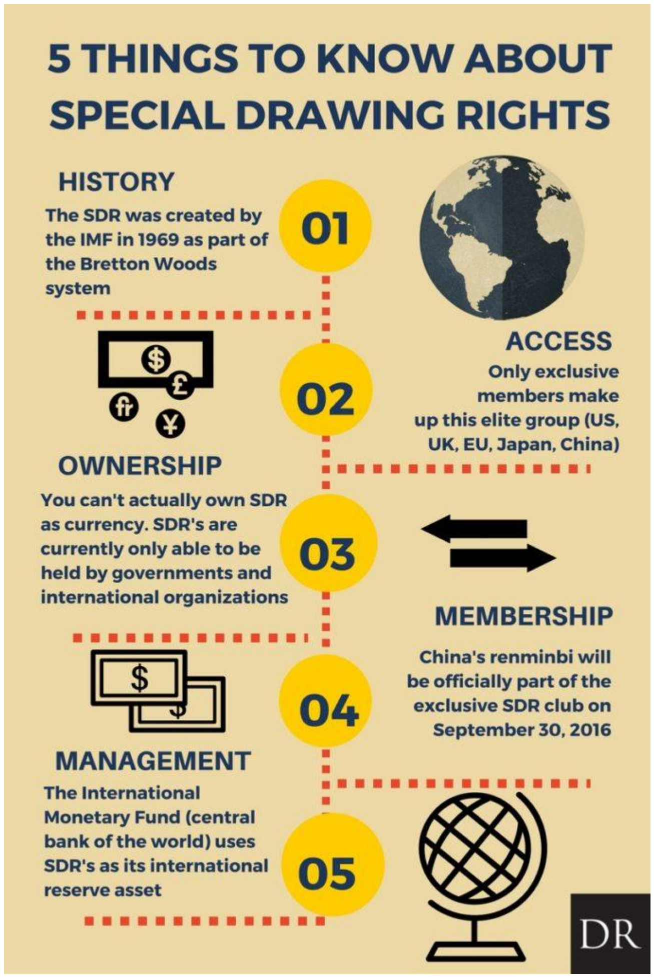
Bretton Woods Agreement & System

In July of 1944, delegates from all 44 allied nations met at the United Nations Monetary and Financial Conference, later to be dubbed the "Bretton Woods Conference (BW." Member states met to chart regulations for the global financial order upon the conclusion of World War 2. The Bretton Woods Conference was ratified a year later upon the surrender of Nazi Germany and Imperial Japan. The agreements signed are today known as the "Bretton Woods System." The system established the International Bank for Reconstruction and Development (IBRD), (later part of the World Bank (WB) group,) and the International Monetary Fund (IMF.) The Bretton Woods system also established the US Dollar as the primary currency of international trade by requiring members to guarantee convertibility of local currency into United States dollars, established a governing order for cooperation between nations to prevent competitive currency devaluation, and established the IMF to govern exchange rate policies and to lend reserve currencies to nations experiencing severe deficits.

Following the abolition of the Gold Standard in the United States, currencies are now free-floating fiats characterized by floating exchange rates. Upon the abolition of the Gold Standard, the Bretton Woods System changed significantly upon the ratification of the Jamaica Accords. The accords allowed for a free-floating system that allows the price of gold to fluctuate with respect to the US dollar and other fiat currencies. The Jamaica Conference also established Special Drawing Rights (SDRs.) SDRs are not a currency, but a foreign exchange reserve maintained by the IMF as a low-credit loan option for developing nations.

Special Drawing Rights

SDRs represent a claim to a currency held by IMF member states. SDRs are meant to serve as a supplementary option for a low income memberstate in anticipation of a shortfall of preferred foreign currencies or assets like USD or gold. Developed countries tend not to use SDRs for any particular purpose, but less developed nations tend to see them as a cheap source of credit. The value of the SDR basket is determined by the IMF every 5 years. As of right now the formula that consists of the SDR basket is as follows: U.S. dollar 43.38%, euro 29.31%, Chinese yuan 12.28%, Japanese yen 7.59%, British pound sterling 7.44%. The SDR is most often relevant during times when the dollar is questioned as a solid foreign exchange currency option. In the case of a conservative monetary policy where the United States is unwilling to put more USDs into circulation, SDRs become more appealing to nations wishing to take out loans and who perceive the dollar as a less attractive reserve asset. SDRs have also become more relevant during times of significant economic turmoil where developing nations who wish to expand their currency reserves but are unable to do so using dollars. Case in point is at the apex of the COVID 19 pandemic. In 2021 the IMF authorized almost 700 billion in SDR allocations to member states in response to balance of payment concerns of many member states.



Origins of the Bretton Woods System

Following the end of World War 1 in the early 20th Century at the Paris Peace Conference, the allies imposed tremendous punitive measures on post-war Germany for damages during the war. There is virtually universal consensus by both economists at the time the conference and today that the tremendous economic crisis that Germany endured in the 1920s was exacerbated by The Treaty of Versailles' imposition of reparations, and that the hyperinflation of the German economy in the interwar period lead to the rise of nativist politicians and the Nazi Regime. There was a specific portion of the treaty commonly known as the "War Guilt Clause" that specified "The Allied and Associated Governments affirm and Germany accepts the responsibility of Germany and her allies for causing all the loss and damage to which the Allied and Associated Governments and their nationals have been subjected as a consequence of the war imposed upon them by the aggression of Germany and her allies." This clause was the primary justification for crushing economic punishments against interwar Germany that would lead to the collapse of the German currency, hyperinflation, and subsequent economic collapse. Germany's economic isolation and turmoil during this period paved the way for the rise of Nazism fueled by anti-semitic conspiracies about Germany's economic woes and set the stage for World War 2.

Having witnessed the role of the treaty on the events leading up to the Second World War, delegates determined that a cooperative framework for the international economic system was necessary to prevent such a war in the future. One of the central ideas behind the Bretton Woods System was the ideas of Open Markets, or the Free Market Economic System. The Free Market Economic System established the framework for how goods are traded today based on a system of supply and demand. Such a system encouraged nations, especially wealthy nations, to remove or even reduce barriers to trade, forgo concepts of economic nationalism, and embrace a globalized approach to modern trade. As globalization has reached a new frontier today, nations are tasked with challenging themselves and their partners as to what changes need to be made to the system to ensure a stable international economic order.

Challenges to the Bretton Woods Institutions

Nationalistic Pressures and Geopolitical Instability

The rise of nationalist politics has come at the detriment of multilateralism Multilateralism has suffered from the rise of nationalist politics . In the United States the Presidency shifted from a President espousing rhetoric against global cooperation to one who pushes for greater multilateral trade agreements. Political volatility of the member states heavily threatens the ability of the institutions to survive.

Geopolitical instability also threatens the stability of the Bretton Woods system as states which are experiencing the greatest need for global financial assistance find themselves too unstable to qualify for IMF loans. When crises occur whether they are caused by domestic factors such as inappropriate fiscal or monetary policies, or external factors such as natural disasters, the Bretton Woods institutions provide loans to address balance of payment issues, insolvent banking institutions, and increasing debt issues. However, nations experiencing one form of monetary crisis are likely to be experiencing others as well. The IMF requires that all nations which receive a loan establish a clear cut plan for debt repayment, something that is not always possible for a nation experiencing multiple financial crises.

A New Geo-Economic Polar System

The largest contributors to the IMF and the World Bank are the United States, Europe, and Japan. But as the Soviet Union collapsed and China became more outwardly global a shift seems to be happening. Globalization has resulted in the expansion of global economic interdependence and trade, private capital flows, and exposure to international events. For example, the War in Ukraine affected the entire global economic order and fundamentally shifted how the IMF does business. The IMF changed its lending rules to accommodate Ukraine, for the first time in its history offering a loan to a nation at war. That institution which has largely attempted to remain apolitical is now under the spotlight with detractors claiming that it is clearly a puppet for Western interests. However, other nations that are at war and struggling are now asking "what about us?"

As nationalistic pressures have increased and nativist rhetoric has increased as well, individual nations have taken the opportunity to circumvent the Bretton Woods institutions and begin lending operations from domestic institutions. China has emerged as the world's largest bilateral creditor to low and middle income countries. For example the Chinese Government announced in 2015 the allocation of 757 million USD to Pakistan to develop the Gwadar Port which will serve as an extension of China's Belt and Road Initiative. The loans are provided to Pakistan under a generous policy granting 0% interest loans. Pakistan will only be required to repay the principal on these loans. China granted this extremely generous package because the extension of the project greatly serves Chinese regional economic interests. However the rise of such bilateral lending projects does raise the question as to how it will gradually impact the IMF's ability to compete for loans. Historically the IMF demands nations that apply for loans to have a plan to pay the loan back, but recently allowed exceptions "situations of exceptionally high uncertainty." Usually Chinese loans do not come with the same expectations of a clear and organized plan for repayment which appeals to low income nations. However, this may be a way for the IMF to justify giving these loans away to compete with Chinese bilateral loans. The caveat however in the case of Ukraine is that the G7 and the European Union have offered financing assurances to the IMF in exchange for Ukraine's loan which means if Ukraine is unable to pay the loan back the G7 + EU may be on the hook to do so.

Existing Bretton Woods Institutional Lending Methodologies

First a member country must submit a formal request for a loan to the IMF. The IMF and the nation's government discuss the nation's economic status and lending needs. The nations and IMF must then agree on an economic policy conditionality program that details the loan repayment programs and oftentimes additional economic reforms intended to stabilize a country's economy. These policy conditions often include imposed neoliberal reforms such as subsidy cuts and social system privatization. Detractors of the policy conditionality argue that these programs are a form of neocolonialism and enforced neoliberalism on countries that are in dire economic straits due to foreign intervention in the first place. Once the lending terms are

agreed upon and negotiated, the policy program is presented to the IMF's Executive Board in a "Letter of Intent." The IMF may then elect to endorse and disburse the loan.
The IMF has multiple lending instruments available to member states. IMF members have access to the General Resources Account from which lending is available on market-based interest rates. The IMF also can provide financial support at 0% interest through its Poverty Reduction and Growth Trust. The IMF also recently established the Resilience and Sustainability Trust to offer long term financing options to low income countries intending to build resilience in the face of external shocks such as natural disaster or war.

<u>Proposed Reforms to the Bretton Woods Institutions</u>

In his essay Modernizing the Bretton Woods Institutions for the twenty-first century, Ajay Chhibber argues that the Bretton Woods institutions are unable to rise to modern day challenges because the structure of these methodologies remain mostly unchanged in the last 80 years. As global crises have exploded, Chhibber argues that the IMF itself is too small. Bilateral lending lines from BRICS and the Chiang Mai initiative have twice the lending capacity of the IMF. IMF resources are now about $1 trillion, which is about 1% of global GDP, not nearly enough to provide necessary lending resources during global crises. Delegates will be challenged to consider how to grow the lending capacity of the IMF.

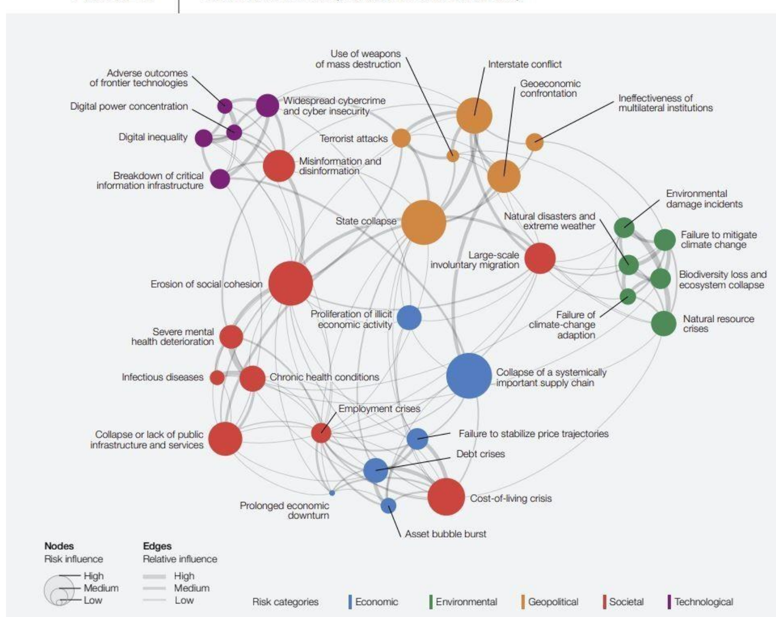


FIGURE C | Global risks landscape: an interconnections map

Some proposed reforms of the Bretton Woods institutions posit that the institutions must be further globalized, that the IMF and WB for the sake of global economic policy, must be more clear as to who does what and what each institution's priorities must be. Currently both institutions are primarily focused on developing nations which has sometimes led to overlapping and confusing actions. Under a proposed reform of the BW system, there must be primary institutions with primary responsibilities. The BW institutions must also focus on debt and require debt-restructuring framework. It is almost assured that many countries will face debt repayment crises in the coming decades. The BW institutions must be tasked with establishing a debt-restructuring system that is suitable to nations both developing and developed.

Chhibber and others have also argued that the IMF needs to reduce mission oriented lending in the case of social, gender, and climate change impacts. While it is important to lend based on these issues sometimes to better understand their global macroeconomic impact, lending on these issues exclusively should likely be left up to other institutions.

Role of the Group of 20 (G20) Committee

The committee meeting for this topic is the G20 Financial Working Group. The G20 comprises many of the world's largest industrial economies. The G20 has a special focus on issues related to the global economic order such as international financial systems, climate change, and sustainable development. The G20 is the most recent iteration of a multilateral organization aimed at coordinating international economic policy coordination in the post-World War 2 era. The G20 includes Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, South Korea, Japan, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States, and the European Union.

Many of these nations have directly competing economic and international policy interests. Some nations in the G20 question the stability of the Bretton Woods system as a whole, some aim to challenge the US and the Western World's domination of the global economic system. Other nations are concerned that volatile military and political ambitions and policies of certain member states can threaten the stability of the Bretton Woods system and the cohesion of the G20.

Guiding Questions:

- How can G20 member states that have directly competing international economic interests compromise on reformation of the Bretton Woods institutions?
- Are there other lending strategies and institutions that the G20 can endorse for the Bretton Woods to use?
- How should loan conditionality be enforced in a way to assure repayment and respect national sovereignty?

- How should the G20 address bilateral lenders engaging in competing low interest loans to underdeveloped nations?
- What reforms can be made to the IMF or World Bank to specifically address major external shock factors to domestic economies such as natural disasters, wars, or climate change?
- Since the IMF has authorized a loan for Ukraine despite the nation being at war, how does this affect IMF lending policy to countries in similar situations?
- How can the World Bank be more effective in its mission to provide financing and policy advice to governments of developing nations?
- Are there certain issues that the Bretton Woods institutions should be more prone to respond to such as in the case of countries that need help responding to crises relating to climate change or war? How can the G20 help establish relevant precedent?