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Robert Triffin International Association - RTI

Reform of the International Monetary System and new global economic governance: how the EU may contribute

Brussels, 6 June 2017,
Jean Monnet Network kick-off event and Triffin Annual Lecture 2017

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Introduction

Christian Ghymers
On behalf of the Jean Monnet Network[1]

The Jean Monnet Network "Crisis-Equity-Democracy for Europe and Latin America" is a research project selected and financed at 80% by the European Commission and, the rest, by a consortium of five academic institutions from Europe and Latin America. These institutions are coordinated by IRELAC – the Interdisciplinary Institute for the Relations between European Union and Latin America and the Caribbean – based in Brussels. The project is organized as a network of bi-regional comparative research on crisis, its management and its social and democratic implications in Europe and Latin America with the aim to mutually learn from each other and to develop policy advice by offering a platform for an exchange of viewpoints to policy makers, academia and the civil society.

Latin America and Europe can both learn from their respective experiences on crisis response and the distributive and democratic implications at national and regional levels. Democratic and distributive aspects of crisis response (monetary, financial & economic policies and institutional reforms) are key but they have not been adequately addressed in literature yet. Furthermore, opening a bi-regional dialogue in the field of socio-macroeconomic policies and crisis management would provide an additional strategic content to the Strategic Alliance that the Summits EU-CELAC are supposed to build.

There is now a broad consensus among economists, political scientists and journalists about the nature of the EU crisis: it is not only an economic crisis, but a governance crisis coupled to a democracy crisis, and this is not only a European disease but a global one as the economic crisis is too. Latin

1. Research project co-financed by the Erasmus+ Programme of the European Union

America is also affected by the global nature of the crisis. Our Jean Monnet Network has the purpose to try to better identify the roots of this crisis by a comparative analysis between both regions.

This ambitious goal requires as a first step to deal with the most global issue which affects both regions: the dysfunctions in the international monetary system, which could even be at the basis of the global crisis. Therefore, it was decided to start the project – the so-called kick-off meetings of our Network – with an international workshop and an international High-level Conference dedicated to focus on the asymmetric International Monetary System. For this purpose, the best partner is the Robert Triffin International association (RTI), which develops analysis along the lines initiated by Triffin sixty years ago about the dysfunctions of a system based mainly upon the US dollar, issuing massive spill overs upon global economy without either effective adjustment mechanism to correct global imbalances nor rational means to moderate or accelerate the growth of global liquidity. Based on this diagnosis, the exchanges of views examine how Europe could act through the present global governance to improve the situation.

The present publication has been made possible thanks to the support of the Camille GUTT Funds, RTI, IRELAC and the (French) Caisse des Dépôts et Consignation (CDC). It points to present, first, the synthesis written by Christian Ghymers, co-coordinator of the Monnet Network, presenting the positions of the Robert Triffin International association – RTI, which were presented and debated in the workshop analysing the major defect of the present International Monetary System. It was shown that the "Triffin dilemma" is still fully at work. Indeed, the use of a national currency, the US $, as the main international reserve currency introduces necessarily an asymmetry which feeds important spill overs on the world's economy. This "built-in destabilizer" produces big liquidity waves with important side-effects on the monetary policies in the rest of the world, but also on the US federal reserve. The present difficulties of the global economy and the challenges that the Central Banks are facing with the effects of their quantitative easing measures and how to get out of them are also a result of the flaw of the IMS, which impedes a rational control of global liquidities. These positions were developed with a view to debate feasible solutions along the logical multilateral coherence of the main option, which consists in improving the Special Drawing Right – SDR by making of it a genuine multilateral currency allowing for a collegial control of global liquidities with a minimum of loss of national sovereignty.

The second part of the kick-off meetings was organized around the Annual Triffin's lecture dedicated this year to analyse how significant Europe's role has been in shaping the new global governance. This part is presented in three contributions. First, the key-note speech, delivered by Marco Buti, Director General, DG for Economic and Financial Affairs, European Commission, has demonstrated once more the continuing relevance of Robert Triffin's ideas, and the renewed search for Global Economic Governance in the aftermath of the 2008 economic and financial crisis and the rising role played by the Group of Twenty (G20). Second, Stephany Griffith Jones (IRELAC and Columbia University) intervened as discussant and presented her views on the need to ensure a more stable way to provide international reserves in a very Triffinian way by developing the use of the SDR.

The last part of this publication is a summary written by Bernard Snoy, Chairman of RTI, of the exchanges in the panel of this 2017 Triffin Lecture.

Upon these bases, the project will organize its successive researches and events in both regions in order to develop a bi-regional socio-economic research network, which could serve as a nucleus of a possible larger EU-CELAC academic network in the future and thus, promote bi-regional cooperation in this area.

We are especially grateful to Viscount Etienne Davignon and Marc Otte, respectively President and Director General of the Royal EGMONT Institute, to Marco Buti from the European Commission, to the Erasmus+ Jean Monnet project, to Baron Michel Vanden Abeele, President of the GUTT Fund, to Baron Snoy et d'Oppuers, President of RTI and to Christophe Bourdillon from the CDC.

The persistence of the Triffin dilemma today: A plan for overcoming it and ensuring a stable international financial architecture

Christian Ghymers
RTI/UCL,[2] and IRELAC[3], Belgium

The Triffin dilemma

More than 50 years ago, the Belgian-American economist Robert Triffin (1911–1993) denounced the dangerous incoherence of the "dollar system", not the general peg-regime against the dollar created in Bretton Woods 1944, but more generally the use of a national currency as the main international reserve currency. His warning was coined the "Triffin dilemma" expressing merely that due to the inner logics of a currency to be a debt-at-sight, any system based mainly on the use of a national currency for supplying international reserve assets to the rest of the world, was doomed to conflicting objectives leading inevitably to generate global macroeconomic instability. The reason is the inescapable dilemma the issuer of this currency faces between either going ever deeper into debt in order to satisfy the growing world demand for liquidity, with the danger that this will undermine its creditworthiness on the one hand, or failing to satisfy this demand by giving priority to its creditworthiness exposing the world to a reserve shortage with a consequent conflictive deflation on the other hand.

The essential message Triffin tirelessly sent to economists and policy-makers is that once a national currency is used as foreign reserve by many other countries, asymmetries are resulting that create biases in the

2. Robert Triffin International Association (RTI), based in the University of Louvain-la-Neuve – UCL – Belgium. The author is very grateful to Bernard Snoy, Chairman of RTI, for his comments and suggestions about this synthesis of the RTI main messages.
3. IRELAC –Interdisciplinary Institute for relations between the EU and the Latin America and the Caribbean, ICHEC- Brussels Management School

policy-mix of the issuer of reserves not only by exempting it from external monetary discipline, but also by provoking significant spillovers on global liquidity conditions, which tend to become suboptimal and unmanageable. He warned that this feature exposes the global economy to unnecessary costly, instability risks. More precisely Triffin viewed these spillovers as symptoms of systemic incoherence, leading him to the conclusion that an International Monetary System based mainly upon a key-currency such as the dollar contains what he called a "built-in destabilizer" i.e. an endogenous generation of global monetary waves that constitute a systemic cause for recurrent global crisis.

In the line of the Keynes plan – which failed to be accepted in Bretton Woods 1944 – he advocated the use of a multilateral currency issued by the IMF, which would not be the debt of any national economy. He proposed a "fully-fledged SDR[4]" as the only way to ensure, with a minimum of loss of sovereignty, the global macroeconomic stability, through a collegial management of international liquidities allowing for a symmetrical anchoring of the monetary system, without any inflationary or deflationary bias.

Today this simple message is not yet sufficiently understood – in fact most often not understood at all. The financial aspects of the global crisis, which started ten years ago, were analysed and mainly understood but the deeper monetary causes of this global crisis seem still to be mainly downplayed or even denied as a cause of the present difficulties. The Robert Triffin International Association (RTI[5]), which is dedicated to the perpetuation of the intellectual heritage of Robert Triffin, launched in 2009 the Triffin 21 Initiative to draw attention to the continuing relevance of the Triffin dilemma: failure to address it was one of the main causes of the global crisis; policy makers overlooked the crucial flaw that the monetary policy stance of the global standard's issuer was not stably anchored but continued to generate significant spillovers upon monetary policies in the rest of the world; if we do not act, we will be condemned to accept blindly pro-cyclical global monetary waves and growing systemic instability with boom-and-bust

4. What Robert Triffin had in mind was a genuine multilateral currency issued by the IMF as the ultimate liquidity used as reserves by Central Banks, not the existing SDR, which is not a genuine currency but merely an asset giving limited access to national key-currencies.
5. Robert Triffin International Association (RTI), https://uclouvain.be/fr/facultes/espo/euro/fondation-triffin.html It replaced the previous Robert Triffin Foundation.

episodes and their consequent high risks of generating socio-political disorders. Ignoring the persistence and relevance of the Triffin dilemma for getting out of the global crisis would be a major policy mistake.

Analytic background of the Triffin Dilemma

The Triffin dilemma relies upon the combination of: (i) the "redundancy issue" or the obvious fact than with "n" currencies there remain only "n-1" degrees of freedom in the international monetary system, and (ii) the cumulative centripetal force which concentrates – as a result of economies of scale and of network – the demand for international reserve from the n-1 countries upon a single vehicle issued by the nth one. Therefore, only n-1 autonomous policies are feasible and the currency which is best endowed for being demanded as reserve by the n-1 others generates asymmetries for this nth economy issuing it, which in counterpart would have to accept passively to validate the net result of the policy choices of the n-1 other national authorities. This means there is over-determination. Therefore, under these assumptions, the US economy, issuing the dollar, recognized as the best-endowed currency, would have to accept to become net debtor as far as the n-1 economies consider beneficial to increase their external reserves and to hold them in dollar assets. Inevitably this system raises two questions: not only the creditworthiness limit for the entities issuing dollar denominated assets but also the lack of anchor for the whole system since the total issued liquidities are totally demand-driven.

Under the gold standard, before the dollar exchange standard, there was a discipline mechanism because gold – an international currency not issued by a national economy i.e. without being a national liability – used to play the role of the "(n+1)th" currency anchoring the whole system by its natural scarcity. This mechanism presented, however, serious drawbacks: it made the whole system dependent upon mining discoveries and geographical or geopolitical factors; while ensuring external stability, it could not guarantee the stability of domestic activity. Therefore, the most logical way to address the Triffin dilemma is merely to add the missing degree of freedom by creating a "(n+1)th" currency i.e. an additional currency not issued as the debt of a specific national economy but by a representative multilateral institution able to regulate credibly its issuance in function of the objective global needs.

It would be difficult to imagine a simpler and more coherent solution. Its logic is the same as the logic that had justified at the national level the creation of national Central Banks for issuing the national most liquid asset required for the clearing among national deposit banks.

There is indeed a contradiction between the unanimous acceptance, for more than a century, by policymakers and economists that, in each country, a central bank must be established above the commercial banks and their continuing almost unanimous reluctance to accept the need for transforming the IMF into an effective multilateral central bank above the national central banks able to add or withdraw international liquidities. At the national level, the move to a central bank entrusted to issue its own at-sight debt for being used as the liquid reserves the commercial banks need, was imposed by the necessity to reduce financial instability which resulted from commercial bank issuances leading to excess of liquid liabilities by individual competing banks. This was in fact a kind of "Triffin dilemma" at national level since it resulted merely from the fact that any non-commodity currency is a debt-at-sight. At the global level, the same kind of systemic risks of instability and spillovers (the Triffin dilemma) calls for the same systemic solution: entrusting a multilateral agency (IMF) to adjust, through issuing or withdrawing, its own liquid debt as a multilateral currency the national banks need as external reserves, upon which they issue their own national monetary bases. The systemic progress would at the global level come from the same monetary principle as at the national level: providing the IMF with a direct mean for regulating global reserve availabilities the same way as any national central bank increases or reduces its at-sight liabilities, i.e. changing the domestic monetary base for regulating commercial bank liquidities without forcing asymmetric commercial bank liabilities changes. Thus, the liquidity constraint among commercial banks must find an equivalent at international level for financing external constraints in a balanced way, preventing the deflationary bias upon global activity inherent to any external adjustment.

Indeed, solving the Triffin dilemma implies not merely to prevent creating too much additional liabilities for the economy(ies) issuing key-currency(ies), but overall to provide a global tool for regulating objectively global liquidities in both directions: preventing the excessive creation of global reserves as much as the occurrence of a global shortage of reserves. The reason to move from an IMS based upon a few national currencies used as international reserves to a single multilateral one is not just for eradicating asymmetries and so-called "exorbitant privileges" that the issuers of reserve currencies would enjoy, but mainly for introducing the missing global lender-of-last-resort making possible a symmetric regulation of global liquidities able to contribute to offset deflationary or inflationary tendencies in effective world demand. The purpose is not to substitute for the US dollar as the efficient technical standard – which remains an objective operational necessity – but to prevent the current system from creating big global monetary waves through asymmetries and spillovers resulting from the domestic US policy-mix, which is unlikely to be able to optimize the world monetary conditions.

Under the present system, in spite of the supposed ability of each country with a floating currency to choose its own domestic stability objective for anchoring its currency, global stability cannot be systemically ensured. The achievement of global stability would require a perfect coordination, which would be utopian. On the other hand, global monetary waves are observed in a real world of increasing policy spillovers, currency substitutions, massive capital flows, fears of floating and exchange-rate interventions – especially in the years 2000s – which created pro-cyclical impacts upon domestic liquidity conditions. The decentralized attempts towards anchoring, relying exclusively upon national policy stances, have been repeatedly proved to be inefficient during the last four decades, as is logical when externalities impede decentralized policies to lead to optimal solution. In particular, when interest rate differentials feed a "carry trade" by borrowing in low interest rate currencies to invest in currency areas with higher interest rates – as it used to be the case in the period 2001–2007 and again especially when the FED had reduced interest rates to virtually zero for several years – there is clear risk to feed a systemic instability.

The Triffin's built-in destabilizer and the origin of the global crisis

The Triffin dilemma provides the intellectual framework to understand why we are currently unable to manage rationally the global monetary liquidities and how the endogenous nature of the world credit-boom has led to the global crisis and is continuing to feed frightening global imbalances. The persistent imbalances continue to expose the world economy to financial instability and at any moment could spark a confidence crisis in the US dollar, which could trigger a sharp adjustment with severe consequences for international trade and economic growth. Contrary to the prevailing opinion among economists, financial deregulation, allowing over-leverage, over-indebtedness and excess of risks, was only a transmission/amplification mechanism but it was not by itself the origin of the crisis. Although financial regulation reforms are necessary, they would not be sufficient to prevent new crises if we are not dealing in parallel with the "built-in destabilizer" identified by Robert Triffin.

Some analytical aspects of this inner destabilizing mechanism of the US dollar system were already presented by C. Ghymers[6] [1986] and R. Triffin[7] [1991]. These aspects are based upon the asymmetry conferred to the US dollar for being the main reserve currency of the system.

This asymmetry – or the destabilizing spillover from the US$ regime, whatever the degree of floating of exchange rates – acts trough two intertwined mechanical channels:

1. Global imbalances do result automatically from the monetary asymmetry resulting from the *lack of external constraint* upon the US economy, which tends to push down the savings rate: external financing is automatically available at an artificially lower interest rate and the dollar tends to be overvalued, which transforms the US into the "*consumer and borrower of last resort*," impeding thus the IMS to fulfil one of its main role, namely to reduce imbalances and to smooth adjustments.
2. Global monetary waves do result automatically from the asymmetric bias introduced in monetary policies by the international status of the $; this bias acts as *a multiplier abroad of the US monetary*, and also indirectly of the fiscal, policy stances, impeding thus the IMS to fulfil its other main role, namely to ensure an adequate degree of global liquidity. The US monetary stance generates automatic liquidity spillovers through two different kinds of links: (i) the conventional mechanism of exchange-rate interventions by the other central banks, which duplicate any excess of US monetary base; indeed, the creation of monetary base abroad as counterpart of the increase in external reserves in dollar is not offset

6. Ghymers, C. "Réagir à l'emprise du dollar", in *L'Ecu et la Vieille Dame*, Aglietta, Michel, Economica, Paris, 1986
7. Triffin, Robert, "The IMS (International Monetary System...or Scandal?) and the EMS (European Monetary System...or Success?)", Jean Monnet lecture, European University Institute, Florence, Banca Nazionale del Lavoro, *Quarterly Review*, n°179, December 1991

by a contraction of the US monetary base since these dollar assets are not deposited on the FED accounts of foreign central banks but are re-injected into the US economy, for instance through investment in US T-Bills and CD on the markets; (ii) the pro-cyclical movements in capital flows, leverage and spreads, as a result of the dramatic increase in the gross cross-border operations of banks combined to the pre-eminent technical role played by the US dollar in global banking, even when exchange rates are purely floating, as demonstrated by Shin Hyun Song[8] (2012, 2014) and Hélène Rey[9] (2013, 2015): a depreciation of the US $ tends to increase leverage outside the US and vice-versa for an appreciation, therefore creating a new channel of transmission of the FED monetary stance without any central bank intervention.

These two channels are inter-related, forming a mutually supportive process of systemic imbalances, creating additional excess of international liquidity, which in turn worsens the imbalances in a destabilizing and costly cycle. This cumulative process is the "built-in de-stabilizer" of the global economy identified by Triffin as the result from the contradiction of using a national currency as the international one. The US official explanation (Greenspan/Bernanke) of a "*World Saving Glut*" provoked by an exogenous shift in the savings supply by some emerging economies represents a typical myopic analysis which assumes implicitly a perfect symmetry (all the currencies would have the same weight and role) i.e. it denies the existence of spillovers created by the international status of the $; this would mean that for the US policymakers, the US economy would be a passive actor, powerless in front of some emerging economies. On the contrary the two channels explain that neither the Chinese saving surpluses nor the US dissaving should be seen as exogenous but that they are closely linked to the international role of the $. Of course, it seems that the Chinese excessive saving rate could also have domestic determinants like a mercantilist policy of undervaluation of the yuan and financial repression. Nevertheless, the reason why these policies could be sustained for such a long time is the dollar system, allowing the almost indefinite accumulation by emerging economies of long-term US bonds, combined with artificially low interest rates also at the long-term end of the US market.

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8. Shin Hyun Song, "Global Banking Glut and Loan Risk Premium", *IMF Economic Review*, Vol. 60, No. 2, 2012.
9. International Channels of Transmission of Monetary Policy and the Mundellian Trilemma, Mundell Fleming Lecture 2014, IMF Economic Review 2015.

While the first channel, i.e. the lack of external constraint, explains that the asymmetric role given to the US $ tends to exacerbate macroeconomic imbalances increasing the US indebtedness, the second one, i.e. the multiplier effect on global monetary policy, explains the strong spillover generated by the US monetary policy upon global liquidity conditions, and the combination of both channels provides a plausible explanation for the dangerous course of the world economy towards a process of crisis amplification, with boom-and-bust episodes, leading to huge losses of global welfare.

Indeed, the cumulative circular causation process appears to be the following:

- The US $ international role implies growing US liquid indebtedness as the counterpart for the accumulation of reserves in $ assets abroad, but the US is not necessarily a net debtor as far as US capital outflows make a counterpart of the $ liquid liabilities: this is the banker's role played by the US, transforming short-term liabilities into long-run assets.
- But the US $ asymmetric role implies also escaping from the external constraint, which means developing a bias towards "easy money" in the form of cheaper interest rates, making fiscal deficits easier to finance and encouraging an excess of absorption over production, i.e. growing macroeconomic imbalances: the US economy is becoming increasingly but painlessly a net debtor (channel 1).
- Facing such a disequilibrium, which promotes imports at the expense of domestic production and drags down activities and jobs in the US economy, the FED tries to keep interest rates as low as possible, stimulating even more the US over-consumption and the external deficits.
- But the monetary spillover (channel 2) amplifies abroad the US monetary expansion as foreign central banks need even more reserves as a self-insurance and/or for resisting to dollar depreciation caused by such a monetary accommodative stance, but doing that means re-injecting the excess of US $ into US liquid assets, lowering further the US yields as well as yields abroad.
- Therefore, the channel 2 amplifies also the effects of channel 1, by creating a vicious circle by which the financing of the growing global imbalances is made possible: the FED feeds in particular the Chinese surplus which absorbs the US T-bills necessary for sustaining this policy stance by a tacit complicity game among these two dominant "players" but under different political objectives.

- This frightening vicious circle of this game of imbalances tends to persist as it appears to be in the mutual interest of both the US debtor and its creditors from some emerging economies; the US domestic growth and employment objectives call for ever more external financing, which the FED is able to feed indirectly through the spillover of its own stances; this in turn allows for more net imports and therefore more accumulation of reserves by the creditors of the US who buy more geopolitical lever upon the US administrations.

Although irrational and destabilizing from a systemic point of view, it is fair to acknowledge that these two channels have also fuelled the global economy and contributed to spread economic development, first in Europe and Japan in the 1950s and 1960s, and later to the benefit of an expanding number of successfully emerging economies. Nevertheless, this positive result cannot hide the succession of crises the amplitude and extension of which are rising. Our hypothesis is that this growing instability is also the result of the asymmetric process described above. Each time it seems that the positive impacts of the FED policy and spillovers are generating the conditions for the next global crisis. According to our argument, the US "solution" to the present global crisis is probably feeding further disequilibrium, leading to the next crisis, which could burst at any time and create a worse issue.

In spite of the impossibility to draw an exact balance between the benefits and costs of the dollar regime, it is clear that it has not led to a stable world and there is no argument for accepting a dysfunctional SMI, which mismanages world liquidity and provokes cumulative monetary policy mistakes. Since economics are supposed to promote rational policies, there is no excuse for postponing actions that could improve a system that feeds instability and remains dangerously unable to fulfil its official purposes.

The international monetary role of the dollar has developed a pyramid of mutually sustained asymmetries:

1. An asymmetry in the degree of *external constraint*, the US economy being exempted of it as far as US $ assets are demanded abroad for reserve purpose.
2. A subsequent asymmetry in the macroeconomic *policy stances* allowing the US to become the "*consumer/borrower-of-last-resort*," absorbing durably both excesses of output and savings coming from the n-1 economies.

3. An asymmetry in the *costs of financing* both US current account deficits and US fiscal debts, in the form of automatic capital inflows absorbing at lower interest rates dollar denominated liabilities.
4. An asymmetry in the *exchange-rate risks* since the US is able to invoice more than others in its own currency as well as to borrow from abroad by issuing liabilities in its own currency, shifting entirely the risk upon the lenders.
5. An asymmetry *in yields* and *valuation effects*, which reflects one aspect of the exorbitant privilege: the higher return on US assets over US liabilities implies an enormous transfer of resources which allows for lowering the effective increase in the US external debt with respect to the cumulative current account deficits, and therefore prolonging even more the disequilibrium.

These combined asymmetries result from the international role of the US $ and represent indeed an "*exorbitant privilege*," which implies significant transfers of real resources from the n-1 economies to the benefit of the US. According to mere bookkeeping calculations, these net transfers were assessed to be around US $ 1 thousand billion from 2001 to 2007 (Alessandrini and Fratianni 2008[10]). Richard Clarida (2009)[11] also shows that between 2002 and 2007, the US net international liability position was almost unchanged even though the US ran cumulative current account deficits for $3.3 trillion in those five years. Gourinchas and Rey (2005)[12] explained the mechanism of leveraged financial intermediary which is made possible by the international role of the $.

The solutions to the Triffin dilemma

Theoretically, there are two possible solutions to the Triffin dilemma: the first, would be an efficient and equitable coordination between the "n" sovereign monetary policies, even more broadly a coordination of their policy mixes.

10. Alessandrini, Pietro and Fratianni, Michele, "Resurrecting Keynes to Stabilize the International Monetary System," Money and Finance Research Group, working paper n°1, Università delle Marche, Ancona, October 2008.
11. Clarida, Richard, "With privilege comes…?," *Global Perspective*, PIMCO, Sydney, October 2009.
12. Gourinchas, Pierre-Olivier, and Rey, Helène, "From World Banker to World Venture Capitalist: US External Adjustment and the Exorbitant Privilege," NBER Working Paper, n°11563, August 2005

This to some extent is what is being attempted by the process of multilateral surveillance under the auspices of the IMF. However, experience shows that this process is not only ineffective but asymmetric: it carries much more weight in countries that depend on the IMF for financing – generally emerging market or developing countries – while the authorities of countries issuing reserve currencies pay only scant attention to the IMF recommendations. The second would be the decision to allow the IMF, transformed into a global central bank, to issue a genuine multilateral currency against national eligible assets; the purpose of both options would be to make feasible a symmetric regulation of global liquidities, able to contribute to offset deflationary or inflationary tendencies in effective world demand.

It must be observed that – contrary to the official views – the second option might in fact be more realistic than achieving a degree of global governance able to coordinate from the centre "n" sovereign policies and to enforce – without sufficient democratic legitimacy or accountability – decisions impacting sovereign states. Indeed, creating a multilateral reserve currency would introduce a more automatic and general "self-constraint" upon the "n" policies with almost no loss of national sovereignty The IMF already exists and is obviously the multilateral body best prepared to manage in a collegial way liquidity creation. Its legitimacy and governance should be strengthened, namely by entrusting final decision-making power to a body comprising ministers and central bank governors, rather than the present Executive Board of senior officials.[13] The Special Drawing Rights (SDR) also constitute the embryo from which a genuine global currency could evolve along the lines proposed in 2014 by a Group of experts assembled by the Triffin International Foundation. Their practical suggestions propose a realistic solution by enhancing the public and the private use of the SDR in order to make it a lever towards a more comprehensive reform of the international monetary system.[14]

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13. See in particular Michael Camdessus and Anoop Singh, "Reforming the international monetary system – A sequenced agenda" The Emerging Markets Forum, 2016.
14. Triffin International Foundation, "Using the Special Drawing Rights as a lever to reform the international monetary system", The Federalist Debate Papers N° 1, CESI Einstein Centre for International Studies, 2014. Also published in bilingual version English/Spanish by the Robert Triffin International Association, in International Monetary Issues n°2, ed. Versant Sud, Brussels, 2015

The New Global Economic Governance: Can Europe Help Win the Peace?

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Global economic governance has evolved dramatically in recent years. Emerging and developing countries have risen in importance. Technological change, faster connections and the rising tide of globalisation in general strengthened economic and financial interdependencies on a global scale. At the political and the institutional level, stepping up international cooperation became indispensable. The global economic and financial crisis served as an accelerator for international cooperation and this is when the Group of Twenty (G20)[16] gained significant importance. With swift and decisive actions, the G20 managed to avoid an outright depression during the financial crisis in 2008 and 2009. However, while there was common agreement on what to do when the crisis broke out, since its end the G20 has been struggling to maintain its relevance.

Questions raised long time ago by Robert Triffin became relevant again. His dilemma captures the following conflict of interest for the system's core country (and reserve currency issuer): when it refuses to provide other countries with its currency, international trade would stagnate; but if it would provide an unlimited supply, global confidence in its currency

15. This article is prepared as follow-up on the Robert Triffin International Conference held on 6 June 2017 in Brussels in the framework of a Jean Monnet/Erasmus+ project dedicated to "Crisis-Equity-Democracy" coordinated by the Interdisciplinary Institute for Relations between the EU and Latin America and the Caribbean (IRELAC-ICHEC), in cooperation with EGMONT Institute and with the support of Robert Triffin International Association (RTI-UCL) and Gutt Fund (ULB). I would like to thank Guergana Stanoeva and Sebastiaan Wijsman for their contribution in preparing it.
16. The G20 includes the following countries Argentina, Australia, Brazil, Canada, China, Germany, France, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, Turkey, United Kingdom, United States, South Africa, South Korea and the EU. Spain has the status of a permanent guest country.

decreases. Although Bretton Woods has ended, the fundamental dilemma as put forward by Robert Triffin is still very much alive: will holders of reserve currencies serve short-term domestic or long-term global interests? By means of this question, Triffin's intellectual legacy is still relevant for today's global economic governance.

With the present article we argue that it is high time that the international community shifted its focus from "winning the war" – i.e. responding to the 2008 crisis – to "winning the peace" – i.e. overcoming the legacy of the crisis and creating conditions for strong, sustainable, balanced and more inclusive growth. Making the case for global cooperation in a multilateral context is all the more critical in the context of rising populism and protectionist threats. But how can global governance become more effective? And what should be the role of the European Union (EU) in this process? Can it be in the lead and help "win the peace"?

The article is organised as follows. First, it presents some important long-term trends in the global economy. Second, it puts global economic governance in a historical perspective by looking at the evolution of the international monetary system and Triffin's dilemma in the heart of it. Third, it highlights the importance of international cooperation and addresses the impact of the financial crisis on global governance. Fourth, it elaborates on the G20 and in particular on its key achievements and remaining challenges. It then depicts the role of the G7 in the global governance and outlines the main challenges facing multilateralism. Finally, it discusses the preconditions for the EU to make a difference in the new global economic governance.

Long-term trends in the global economy

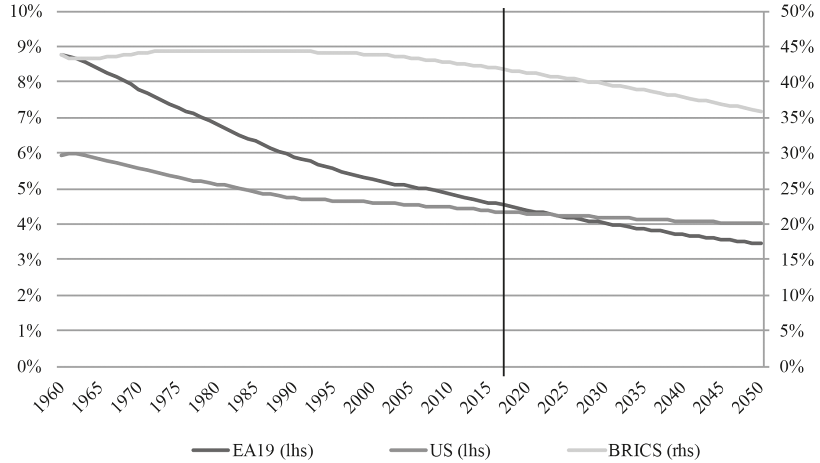
The rise of emerging markets and developing countries in the international economy is driven by changes in growth dynamics and demographic developments. First, the population of emerging markets is increasing relative to the population of advanced economies. Figure 1 depicts the share of the BRICS[17], Euro Area (EA) and United States (US) in world population. In the

17. Brazil, Russia, India, China and South Africa.

1960s the BRICS' population was three times larger than the combined population of the US and the EA. Today, this ratio has increased to four and a half, whereas long-term projections point to a BRICS' population that could be five times larger in 2050. Moreover, the share of the BRICS' population itself is expected to decline relative to the other (non-BRICS) emerging and developing economies.

Figure 1

Population of EA19, US and BRICS as share of world population

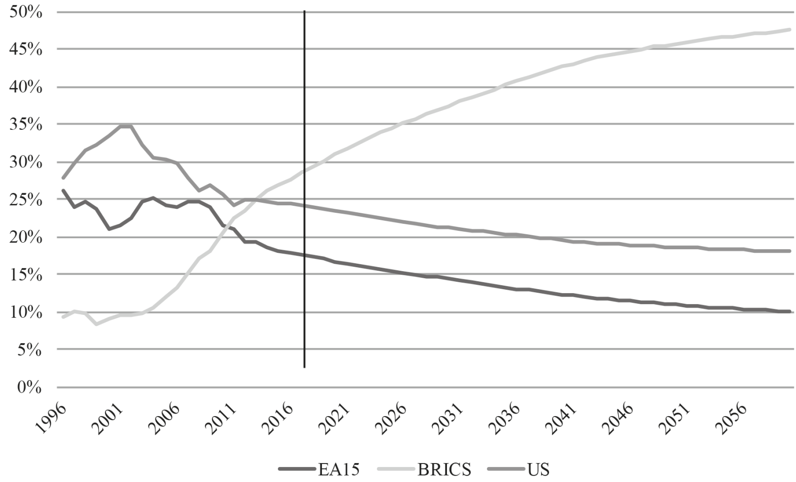


Source: World Bank

Second, turning to growth dynamics, Figure 2 shows how the BRICS' share in the world economic growth is expected to rise in relative economic weight from around 10% of global GDP in the late 20th century to over 45% by the middle of the 21th century. On the contrary, the EA's and US' share in the world economic growth declines. This implies a shift of global economic power from advanced to emerging and developing countries.

Figure 2

Real GDP at market exchange rates as share of world total



Source: OECD long-term baseline projections (June 2013).

Notes: 1) Actual GDP data until 2012. From 2013 to 2015, GDP data from the OECD Economic Outlook. From 2016, GDP data from the OECD long-term baseline projections.

2) EA15 includes Austria, Belgium, Germany, Spain, Estonia, Finland, France, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Slovakia and Slovenia. The OECD does not provide data for the rest of the EA Member States.

One of the factors behind the loss of GDP share of the advanced economies is the slowdown of productivity growth. As Figure 3 indicates, labour productivity grows considerably faster in emerging markets than in advanced economies. Low productivity growth in the latter was already underway before the financial crisis and has continued to undermine rises in output and living standards in recent years.

Figure 3

Labour productivity growth (as output per employee)

Source: Conference Board. Note: Growth is measured as annual percentage change on three-year moving averages

The global governance system: A historical perspective

These long-term trends have not affected global governance until recently. After the Second World War, the global economic governance was structured around the so-called Bretton Woods system which encompassed a number of rules and institutions. Bretton woods, named after the area in New Hampshire (US) where it was agreed, established the International Monetary Fund (IMF) and the World Bank as central institutions in 1944. Three years later, the General Agreement on Tariffs and Trade (GATT), the precursor of the World Trade Organisation, was signed in Geneva.

As regards the international monetary system, the central feature of Bretton Woods was a fixed exchange rate of all currencies vis-à-vis the US dollar.

The central role of the US dollar in this system maintained and reinforced the role of the US in global governance. However, already by the early 1960s, US monetary liabilities towards non-residents exceeded US gold holdings. Hence the well-known Triffin dilemma: If the US refused to provide other countries with US dollars, trade would stagnate and the world economy would eventually be trapped in a deflationary bias. However, if the US provided an unlimited supply of dollars, the certainty that it would convert them into gold would erode confidence in its international currency.

The system eventually collapsed, as Triffin had predicted. Faced with the dilemma, the system's core country preferred not to maintain its commitment to keep the value of the dollar in terms of gold, but rather to pursue its internal needs while providing the other countries (which were not adjusting either) with its reserve currency. US policymakers' lack of regard for repercussions on other economies meant that this was at the same time an international "non-system", and a unipolar system based on the dollar. In the long run this proved unsustainable, and the end of the Bretton Woods system started with the decision by President Nixon in 1971 to unilaterally terminate the convertibility of the US dollar into gold. Compounded by the first oil price shock, by 1973 the major currencies began to float against each other.

After the end of the Bretton Woods system, global economic governance evolved towards a more multipolar system. The international monetary system is no longer solely centred on the US dollar, but is increasingly built on several pillars, including an important role for the euro and the yen, and a Renminbi which is growing in significance.

Has this put an end to the Triffin dilemma? The way in which the international monetary system works has changed and thus the modalities through which the dilemma operates have changed considerably. However, the fundamental tension between short-term domestic policy incentives and the stability of the international monetary system has not. Key issuers and holders of reserve currencies pursue domestic objectives independently of what would best serve the global system and even their longer-run interest. To the extent that these policies pay insufficient attention to negative externalities for other countries and longer-term macroeconomic and financial stability concerns, they tend to produce unsustainable imbalances and fuel vulnerability in the global financial system. Hence, the Triffin dilemma is essentially still alive.

The global economic and financial crisis: Accelerator of global economic policy cooperation

The economic and financial crisis that broke out in 2008 demonstrated the high degree of global interdependence and the importance of effective global governance. The crisis taught us three key lessons: First, global spillovers transmitted via financial markets can have dramatic consequences. For example, the Greek debt crisis had a direct impact on other economies in Europe and beyond.

Second, financial and monetary stability have a global dimension. The exchange rate does not insulate national economies in a world of free capital movements. For the past few decades, international macroeconomics has postulated the so-called "financial trilemma": With free capital mobility, independent monetary policies are feasible if and only if exchange rates are floating. Some analysts (see for example Helene Rey (2013)[18]) argue that widespread co-movement in capital flows, asset prices and credit growth across countries – a global financial cycle – makes the trilemma moot: This financial cycle "transforms the trilemma into a 'dilemma,' or 'irreconcilable duo', implying that independent monetary policies are possible if and only if the capital account is managed. Hence, the conclusion is that countries that want to keep capital markets open must choose between monetary autonomy and exchange-rate management.

Third, in a post-crisis world, close cooperation between policy makers is essential to avoid zero-sum 'beggar-thy-neighbour' policies. The term 'currency war' gained widespread publicity in 2010, in the context of the G20, by then-Brazilian Finance Minister Guido Mantega to depict competitive devaluation, i.e. countries competing against each other to achieve relatively low exchange rates for their own currencies in search of competitive advantage.

In addition to its economic impact, the financial crisis also had major consequences at the institutional level. The perception of the relative decline of advanced economies accentuated by the crisis boosted the confidence

18. Helene Rey (2013) "Dilemma not Trilemma: The Global Financial Cycle and Monetary Policy Independence".

of emerging powers. Emerging and developing economies called for faster reform of global institutions, especially of the IMF and the World Bank. As a result, a number of global institutional innovations took place to address the challenges of the crisis. Most importantly, the G20 was elevated from a Finance Ministers' group to the level of Heads of State and Government.

G20: Key achievements, decisions and challenges

The G20 has emerged as an informal forum that promotes cooperation between advanced and emerging-market countries on key challenges related to global economic growth and stability. It represents almost 90% of global GDP, two-third of the world's population and 80% of world trade. At the 2009 Pittsburgh Summit, the G20 designated itself the premier forum for international economic cooperation.

Over the years, the G20 has proved to be an effective forum bringing advanced and emerging economies together. It has demonstrated that it can take swift and decisive action when dealing with the global financial crisis in 2008-2009. Moreover, the G20 has helped to reduce the mistrust between advanced economies and emerging markets for the benefit of all. In doing so, the G20 has been the platform countries were looking for to exert influence on partner countries' policies that were producing significant spillovers.

Key decisions

There are several key decisions that shaped the G20's influence. When the global crisis broke out in 2008-2009, the G20 managed to avoid a 1930s style great depression, through a coordinated G20 response to the global recession and the stabilisation of the financial system. The Summits in Washington (November 2008), London (April 2009) and Pittsburgh (September 2009) focused on four key issues: (a) the macroeconomic stimulus needed to avoid the repetition of depression similar to that of the 1930s; (b) the tripling of the financial resources of the IMF to strengthen global firewalls and support countries under financial stress because of the crisis; (c) the agreement to implement reforms to restore the stability of financial markets in order to avoid a collapse, and to strengthen regulatory and supervisory regimes so as to avoid future crises; and (d) finally, the commitment to refrain from protectionism (in contrast to the 1930s) and roll back restrictive trade and investment measures taken previously.

The enacted macroeconomic packages were without precedent both for their size and in terms of the economies involved in this coordinated policy response. Aggressive monetary policies together with expansionary fiscal policies (amounting to several points of GDP and complemented by the work of automatic stabilisers) contributed to stem the collapse of demand and to bring global growth in positive territory already in the second half of 2009. Results were so encouraging that at the Toronto Summit in June 2010, it was decided to start withdrawing the fiscal stimulus, which from hindsight turned out to be a premature decision.

After these turbulent years, the G20 started to focus on structural changes. At the summit in Seoul in November 2010, the Leaders' most important decision was to finalise the IMF quota reform which included a doubling of the overall quota of the Fund, a significant (6.4%) shift of IMF shares to emerging market and developing countries and a reduction of the advanced European presence in the Executive Board by two seats in favour of emerging market countries. At the Cannes Summit in 2011, Leaders agreed on a common methodology to approach global imbalances. This resulted in a number of policy recommendations to be taken in a coordinated way in surplus and deficit countries in order to put global imbalances on a downward path and in the meantime ensure a rotation of global demand that would support economic activity. In St Petersburg in September 2013, the G20 decided to address base erosion and profit shifting, tackle tax avoidance, and promote tax transparency and automatic exchange of tax information. At the Brisbane summit in November 2014, the G20 put forward structural reform measures and growth strategies to meet the ambitious goal of lifting its collective GDP by more than 2 per cent over five years. Finally, at the Hangzhou summit in September 2016 G20 members agreed to use all policy tools (monetary, fiscal and structural) individually and collectively to achieve the goal of strong, sustainable, balanced and inclusive growth. It was acknowledged that monetary alone cannot lead to balanced growth and should be supported by fiscal policies and structural reforms.

Remaining challenges

However, there also remain challenges for the G20. First, in order to stay relevant, the G20 needs to develop itself from a short-term crisis response forum to addressing more long-term challenges for the global economy It has responded adequately to the 2008 crisis but it should now overcome the crisis' legacy and create the conditions for strong, sustainable and balanced growth. Second, for the credibility and effectiveness of the G20, it is essential that members implement their existing G20 commitments, for example on international tax transparency and financial regulatory reform. Consistent monitoring will be essential to ensure effectiveness of reform and a global level playing field. Third, given its diverse membership, the G20 needs to show leadership to identify points of common interest and new topics to cooperate on, such as anti-terrorism financing or digitalisation. Finally, the G20 must address the backlash against globalisation and focus on its unfair benefit distribution which risks fuelling populism.

Challenges to multilateralism

Along with recent developments, a number of challenges to multilateralism are emerging. Divergences among major advanced economies are traditionally dealt with in the Group of Seven, commonly referred to as G7[19]. Until recently, the G7 was the internal caucus on key G20 issues like trade, financial regulation climate change. Common positions on these have also helped the G20 move forward. However, the attitude of the new US administration risks changing fundamentally the global coordination game. Consensus is breaking down with bilateralism threatening the multilateral, rules-based system and mistrust setting in. Traditional "exogenous" assumptions are being questioned. Global fora risk being seen more as an amplifier to a bilateral agenda rather than looking for genuine multilateral solutions to common challenges. There is not only a risk of an increased shift to bilateralism for trade agreements, but also a US disengagement may be looming for what concerns the international monetary system, competitive tax shifts may emerge and there is a

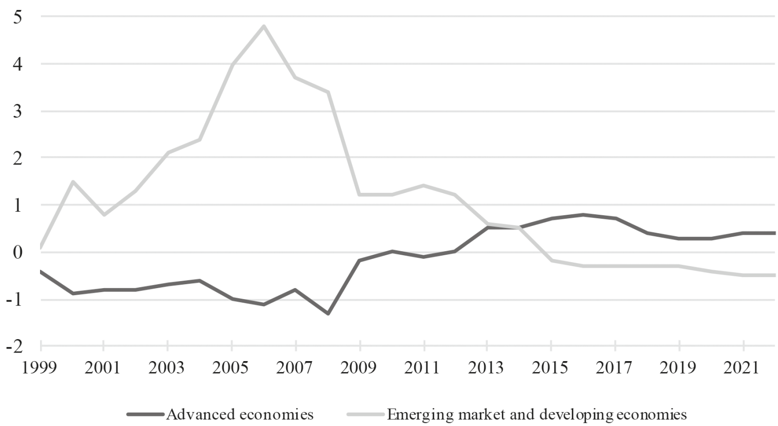
19. The G7 consists of the UK, France, Germany, Italy, Japan and the US

risk of rolling back on financial regulation. Moreover, cooperative solutions are lacking to effectively tackle the migration challenge and climate change.

In this challenging environment, a renewed rise in global imbalances may be the trigger ending multilateral cooperation. External imbalances may be problematic if they are excessive and entrenched. Disorderly unwinding of large current account surplus or deficits can have high costs in terms of output and employment and could have significant spillovers on trade and financial partners. As figure 4 shows, there was a large imbalance during the pre-crisis period. While the US' current account deficit represented almost 6% of GDP in 2006, China's current account showed a surplus of 10% in 2007. After having reached a peak in the run-up to the crisis, global imbalances went through an important correction, mainly on the side of emerging economies.

Figure 4

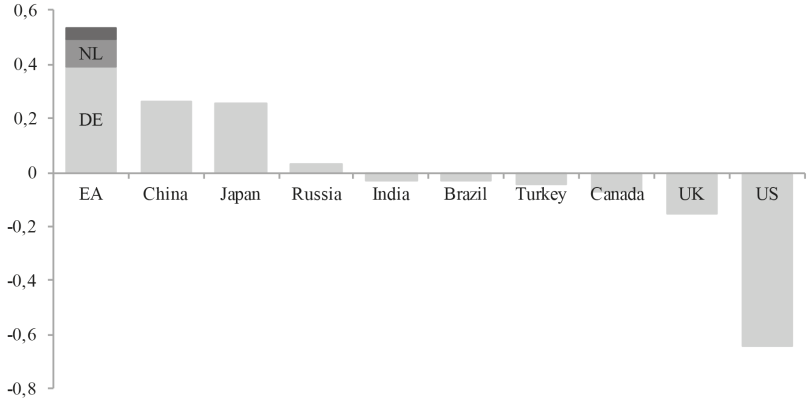
The current account as percentage of GDP



Source: IMF Data Mapper

In recent years, the positions are being reversed: Emerging market and developing economies as a whole run small deficits while advanced economies register surpluses. Figure 5 depicts the current account balances as percentage of global GDP for some individual countries in 2016. Japan, China, Russia and the EA show current account surpluses. India, Brazil, Turkey, Canada, the UK, and US have (small) deficits.

Figure 5
The current account in 2016 as percentage of global GDP



Source: Calculations based on IMF Data Mapper

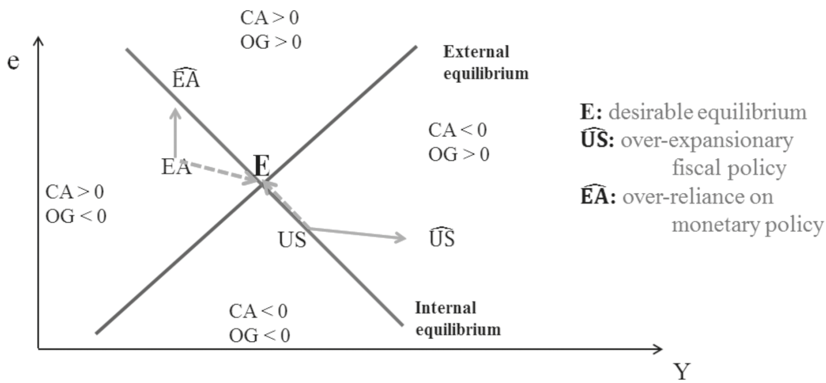
The global imbalances become more an advanced economies problem rather than an emerging markets one. Focusing on the EA situation, we can see that Germany and the Netherlands have the highest current account surpluses in the EA. However, also previous deficit countries have started to reduce their deficits or even turned into surplus as part of the adjustment process. Consequently, the overall EA current account surplus attained historically high levels.

This development brings forward several risks. The EA needs to avoid that asymmetric adjustment increases its current account surplus even further. The unbalanced policy mix in the US which combines higher fiscal spending with sharper than expected rise in interest rates, could affect the dollar-euro exchange rate and increase the US deficit and protectionist pressures. This may be coupled with risks of hard-landing (i.e. disorderly adjustment) in China.

The rise of renewed global imbalances can be represented by the so-called Swan diagram as depicted in Figure 6. The Swan diagram illustrates the combination of aggregate demand (horizontal axis) and the real exchange rate (vertical axis) that ensures an internal and external equilibrium. The internal equilibrium contains all the points in which the output gap is zero and is represented as the downward sloping line. The upward sloping line represents the external equilibrium and contains all the points resulting in a current account balance. The graph has four quadrants accordingly in which the actual and desirable policy positions of the US and EA are reflected.

Figure 6

Global imbalance fuelled by unbalanced policy mix



The risk is that an over-expansionary fiscal policy in the US going hand in hand with more rapid normalisation of monetary policy would lead to an appreciation of the US dollar and a larger current account deficit. Conversely, over-reliance on monetary policy would imply the continuation of historically high current account surpluses in the EA. The spillovers of an unbalanced policy mix in the US would be sizeable, in particular for emerging economies having a large share of dollar-denominated debt (that is in some cases unhedged).

Preconditions for the EU to count

In order for the EU to make a difference in global governance going forward, it will need to meet a number of preconditions. First, projecting strength externally requires internal strength, which means the EU needs a higher degree of internal EU cohesion. In particular, this means the EU must complete the Single Market and become a genuine Economic and Monetary

Union – including through a stronger economic and fiscal governance framework, a fully working Banking Union and a Capitals Market Union. The Commission Reflection Paper on deepening EMU published in May 2017 indicates the possible way forward. This was followed by a package setting out a roadmap for deepening of EMU in December 2017 including concrete steps to be taken over the following 18 months[20]. The EU also needs to overcome political challenges, in particular the migration crisis and Brexit.

Second, to make a difference globally, the EU should overcome its "small country syndrome". The EU consists of small and large countries, but many Member States, for historical reasons or otherwise, focus purely on domestic objectives and are not ready to take up broader responsibilities.

Third, the political phenomenon of the "small country syndrome" also has an economic counterpart, which can be labelled the "reverse creditor paradox". Historically, going back to Bretton Woods and before, creditors were in a stronger position, compared with the weaker position traditionally held by debtor countries. An asymmetry reigned in the international system, which meant that creditors ruled, as could also be seen during the euro area debt crisis. This political asymmetry has now been reversed. Therefore, the EU and EA are now at risk of a sort of "reverse creditor paradox".

Fourth, the EA as a whole runs a large current account surplus which makes it vulnerable for criticism from other countries. Large current account surpluses do not contribute to global economic growth and demand, and export deflation. Surpluses are accordingly no longer seen as strength but rather as a sign of economic weakness and a source of political vulnerability. The EU is subject to the risk of attracting concentric fire from the US for not assuming its responsibility to boost global growth. At the same time emerging markets may criticize the EU for not acknowledging the shifts of power in global economy.

20. For more information on the European Commission package see: http://europa.eu/rapid/press-release_IP-17-5005_en.htm

Leveraging strengths

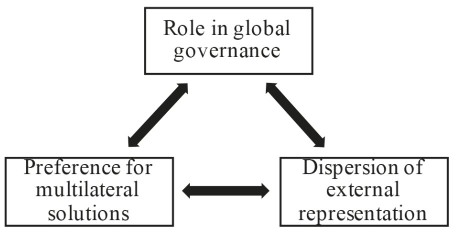
To overcome its weaknesses and to make a difference in global governance the EU should leverage its strengths. This means leveraging the attractive aspects of the European model to enhance the 'soft power' of the EU. In particularly the following four strengths can be leveraged by the EU.

First, the European social model is attractive for international partners, since it combines equality and growth. Second, by means of its environmental model, the EU has been at the forefront on many global environmental issues and on the fight against climate change. For instance, the EU was a driving force in reaching the first universal, legally binding global climate deal at the Paris COP21 conference in December 2015. Third, the EU is strongly committed to effective multilateralism. It always stands ready to work with its international partners on multilateral, win-win solutions. Finally, the EU at the moment represents a beacon of stability. Whilst for a long time it was in the eye of the storm during the crisis it is now seen as an anchor point of the world. Many of its international partners emphasise that they see the integration the EU and EA achieved as an "important global public good" that needs to be preserved and completed.

Reform EU's external governance

Besides strengthening its domestic governance, the EU should also reform its external governance. A new impossible trinity has emerged: It is not possible to achieve an important role in global governance if representation in multilateral forums remains that of Member States alone.

Figure 7
Overcoming the inconsistent trinity



Europe, and notably the EA, must be able to speak with one voice to make full use of its position. This requires a balancing act between integrated and national policies and institutions for their representation in multilateral forums. In forums such as the IMF, the G20 and the Financial Stability Board, Europe's representation remains dispersed while these forums decide on issues of key importance for global economic governance, such as the stability of the international economic system and the need to rebalance economies. Fragmented external representation leads to a lesser weight for the European message to the world or it weakens the effectiveness of the multilateral global governance framework via a tangle of state-to-state bilateral agreements. Only a single external voice, at least at the EA level, along the lines of the proposition of the Five Presidents' Report and the Commission Reflection paper on deepening EMU, can be conducive to a greater influence in global decisionmaking.

Conclusions

Since the abolishment of Bretton Woods, global economic governance has moved towards a multipolar system. Economic and demographic developments have changed economic weights and shifted trade patterns. Emerging and developing economies gained importance and the global governance has changed accordingly, whereas the financial crisis of 2008-2009 spurred this process. Moreover, the financial crisis showed the importance of coordinated economic governance as financial spillovers spread the crisis across the world and the rise of the G20 was a major innovation resulting from this.

Although the G20 took swift action as response to the crisis, it struggles since then to remain relevant. It should move its focus from "winning the war", i.e. responding to the crisis to avoid the collapse of the global financial system, to "winning the peace", i.e. enhance conditions for strong, sustainable and more inclusive growth. At the same time, multilateralism faces challenges like excessive imbalances, opportunistic tax policies and protectionist pressures. Economic coordination provides clear benefits and the EU can strongly contribute in this respect.

However, to play a role in global governance, the EU needs to address its weaknesses, leverage its strengths and overcome the fragmentation of its external representation.

Finally, Robert Triffin addressed the ever changing nature of global economic governance as follows: "... the construction of a stable and freer system of world trade and payments must be conceived as a continuing and permanent effort to adjust international institutions and policies to new needs and new possibilities". This accurately describes what the European Commission is trying to deliver in the G20 and other multilateral fora.

Reform of the International Monetary System and the IMF comments on Marco Buti's presentation

Stephany Griffith-Jones
IRELAC & Columbia University

Europe

European growth

Growth in the European Union, and specifically in the Eurozone was very anemic and disappointing, after the 2007/9 crisis and till 2015. In fact, growth in EU was much slower than in the United States. This was accompanied by very high levels of unemployment, especially in countries like Greece and Spain. Fortunately, since 2016 all EU economies have been growing and are projected to grow in the next two years.

Indeed, in the last two and a half years, the Eurozone grew 5.1%, which was faster than the United States, that grew 4.6%.

Widening divergences

There have been widening divergences in economic growth and employment levels between the more successful and the weaker European economies. Unemployment rates, especially of the young, have been extremely high in the countries that suffered crises, whereas countries like Germany have very low levels of unemployment.

These problematic aspects had implied loss of faith in the future in the European Union.

Slow growth in the EU has had a depressive effect on world trade and on the growth of the rest of the world, including the emerging and developing economies.

Current account surplus large

The Eurozone as a whole has a large current account surplus, which reached more than 0.5% of world GDP in 2016, according to data from the International Monetary Fund. Most of this current account surplus is in Germany, where it represented almost 0.4% of world GDP. In absolute values, German current account surplus is the largest in the world, reaching 8.6% of German GDP in 2016, however, Dutch current account surplus, at 10.0 % is even higher as proportion of GDP.

As Keynes pointed out so clearly in the mid-1940s, during the run up to the negotiations at Bretton Woods, and as was then followed up by Robert Triffin during the next decades, management of current account imbalances is key at the global level to maintain growth.

In the current system, deficit countries are forced to adjust, due for example to a sudden stop of private capital inflows, (or even worse, due to a reversal of such flows and/or capital flight by its citizens), or by a sharp increase in the cost of external finance. The only source of funding then, are official flows, accompanied by strong conditionality, requiring strict austerity. Then, the burden of adjustment falls only or mainly on the deficit countries, if no offsetting expansionary policies are adopted in creditor countries. This means the policy thrust in the whole EU region is recessionary as a whole.

Adjustment in surplus countries is therefore also needed; this can be implemented via higher wage growth, and some expansion of fiscal policy, via higher public investment. This will be good for growth and improved income distribution in those countries, and will have positive spillovers for neighbouring countries, including deficit ones. It will also be good for growth in the Eurozone as a whole, and in the world economy.

By adjusting, surplus current account surplus countries would turn the negative externalities they are currently generating, which impose costs on deficit countries, into positive externalities.

International financial and monetary reform

Financial regulation

In the crucial area of financial regulation, much progress has been achieved, nationally, at EU level and internationally. However, a key question is whether enough progress been achieved, to prevent another major financial crisis?

Additional concerns are delays and watering down in implementation, due in great part to political economy pressures from the financial industry. Finally, last but not least is the threat in the US of a reversal of financial regulation.

In this difficult context, the European Union has a particularly major and key role to play.

An important limitation of current financial regulation is that domestic financial regulation and its reform does not include regulation of capital flows, which should be integrated into the broader discussion. In this area, it is encouraging that the International Monetary Fund has changed its views on regulating capital flows quite remarkably, change which is very positive.

After the very costly financial crisis in the US, and especially the Eurozone, a daring and apparently radical but relevant question seems to be if full freedom of capital flows in developed economies is optimum for them. If not, should macro-prudential regulation on capital flows be part of the regulatory toolbox, also in developed economies?

Current global reserve system

The current global multi-currency system has three major problems.

The first problem is that it makes it more likely that there is asymmetric adjustment between deficit and surplus countries. As discussed, this implies a global recessionary bias. This can be called the Keynes problem.

The second problem is the Triffin dilemma. As based mainly on the US$, the current international monetary arrangements require the United States to have a current account deficit, so that enough international liquidity is provided. This may erode confidence in the US $ and/or may lead to financial crises. Indeed capital flows to the US, which helped fund the US current account deficit, helped fuel the US sub-prime crisis, which was transformed into the global financial crisis.

More broadly, the current system implies that world economy, and its financial stability, is too reliant on US monetary policy. As Jose Antonio Ocampo clearly puts it, the world needs (using the terminology of the 1960s) a less 'erratic' and 'capricious' system for providing global reserves, and particularly one that is not hostage to the macroeconomic policies and the potential effects of the deterioration in the net investment position of the United States.

The third problem is the inequity bias. The current international monetary system requires emerging economies to self-insure, both due to fluctuating terms of trade and, especially due to volatile capital flows. The most frequent way of self-insurance used by those countries is through large foreign exchange reserves, which gives these countries policy-space.

A problem for those countries is that this is costly, as they borrow at fairly high interest rates, and tend to invest their reserves in US and other developed economies, especially government bonds, which have a very low yield.

A solution, long proposed in the Keynes and Triffin tradition, is to increase the role of the Special Drawing Rights, or SDRs. A more specific proposal is to increase the role of SDRs specially to fund IMF operations, in a counter-cyclical way, whilst simultaneously guaranteeing that the supply of SDRs reflects the additional global demand for foreign exchange reserves. Most estimates indicate that average allocations for the equivalent of US$200–300 billion a year would be reasonable, but even this allocation would only increase the share of SDRs in non-gold reserves to just over one-tenth in the 2020s, indicating that SDRs would largely complement other reserve assets.

As Ocampo and others have pointed out, even a moderate move in this direction would go a long way to reduce the three major problems of the current system. First, the associated "seignorage" would accrue to all IMF members. Second, by issuing SDRs in a counter-cyclical way, it can contribute to reducing the recessionary bias associated with the asymmetric adjustment problem. Third, SDR allocations could reduce the need for precautionary reserve accumulation by developing countries, and would represent a lower cost of building self-protection than accumulating international reserves through borrowing or building up current account surpluses.

The most important reform, in any case, would be to finance *all* IMF lending with SDRs, thus making global monetary creation similar to how central banks create domestic money. This would build on the proposals made by the late IMF economist Jacques Polak almost four decades ago. According to his proposal, IMF lending during crises would create new SDRs, but such SDRs would be automatically destroyed once such loans are paid for. The alternative Ocampo suggested is to treat the SDRs not used by countries as deposits in (or lending to) the IMF that could then be used by the institution to lend to countries in need.

Summing up of the Panel of 2017 Annual Triffin Lecture

Bernard Snoy et d'Oppuers
Chairman of Robert Triffin International Association – RTI/UCL

To-day's conference, with the Annual Triffin's lecture delivered by Marco Buti, Director General, DG for Economic and Financial Affairs, European Commission, has demonstrated once more the continuing relevance of Robert Triffin's ideas, following up on the Triffin's lectures of preceding years delivered by personalities such as Tommaso Padoa-Scioppa, Lorenzo Bini Smaghi, Michel Camdessus and Jose Antonio Ocampo.

Marco Buti placed the questions raised a long time ago by Robert Triffin in the context of the renewed search for Global Economic Governance in the aftermath of the 2008 economic and financial crisis and the rising role played by the Group of Twenty (G20), trying to answer the question RTI had put to him, namely how significant has been Europe's role in shaping the new global governance. Marco Buti broadened the issue, arguing that "it is high time that the international community shifted its focus from 'winning the war' – i.e responding to the 2008 crisis – to 'winning the peace' - i.e. overcoming the legacy of the crisis and creating conditions for strong, sustainable, balanced and more inclusive growth".

Marco Buti put this question in the context of long term demographic, GDP and productivity trends as well as in an historical perspective, reminding us of the impact of the financial crisis as an accelerator of global economic policy cooperation, with the G20 becoming the key global forum, the emerging powers asserting themselves, the international monetary system becoming more multipolar, with the euro, the yen and the Renminbi growing in significance alongside the dollar.

Has this put an end to the Triffin dilemma? Buti says no. The fundamental tension between short term domestic policy incentives and the stability of the international monetary system is still there. "Key issuers and holders of reserves currencies pursue domestic objectives independently of what would best serve the global system and even their longer-run interest. To the extent that these policies pay insufficient attention to negative externalities for other countries and longer-term macroeconomic and financial stability concerns, they tend to produce unsustainable imbalances and fuel vulnerability in the global financial system".

In Marco Buti's eyes, there is no doubt that the G20 has demonstrated its capacity to take swift and decisive action when dealing with the global financial crisis in 2008-2009, to reduce the mistrust between advanced and emerging countries: it provided the platform countries were looking for to exert influence on partner countries' policies that were producing significant spillovers. One of the most important G20 decision was the tripling of the financial resources of the IMF (including an allocation of 250 billion dollars in SDRs) and the IMF quota reform. However, to stay relevant, the G20 needs to develop itself from a short-term crisis response forum to addressing more long-term challenges for the global economy. Unfortunately, this coincides with new challenges to multilateralism, coming among others from US disengagement from multilateral fora and preference for bilateralism. In this difficult context, we should prevent the renewed rise in global imbalances from becoming the trigger ending multilateral cooperation. The global imbalances are becoming more an advanced economies problem rather than an emerging market one. The combination of a historically high Euro-Area (EA) current account surplus (underpinned by the excessive German and Dutch current account surpluses and over-reliance on monetary policy) and the unbalanced policy mix in the US (over-expansionary fiscal policy and more rapid normalisation of monetary policy) could generate serious tensions.

Buti showed us that in order for the EU to make a difference in global governance going forward, it will need to meet a number of preconditions, including completing the EMU architecture, addressing the current account surpluses, which appear now as a sign of economic weakness and a source of vulnerability, and overcoming the dispersion of its external representation. The implementation of these conditions requires strong leadership and political will but they would make it possible for the EU to enhance its soft power in the G20 and other fora, building on the attractive features of the European social and environmental model and the EU's strong commitment to effective multilateralism, In her comments on Marco Buti's presentation, **Stephany Griffith-Jones** (IRELAC and Professor at Columbia University), focused also on the links between current account imbalances in the EU and growth. While the burden of adjustment has fallen excessively in the past on the deficit countries, she argued that adjustment in surplus countries such as Germany and the Netherlands, via higher wages growth, some expansion of fiscal policy and higher public investment, would be good for growth and improved income distribution not only in these countries but for the Euro Area as a whole and for the world economy.

On financial regulation, although much progress has been achieved since the 2008 crisis, she expressed concern that the new US administration could trigger a reversal of financial regulation. Referring to the change of attitude of the IMF on regulating capital flows, she wondered whether, also in developed economies, macro-prudential regulation on capital flows should be part of the regulatory toolbox.

On the current global reserve system and the Triffin dilemma, she echoed Jose Antonio Ocampo's statement that "the world needs a less erratic and capricious system for providing global reserves, one that is not hostage to the macroeconomic policies and the potential effects of the deterioration in the net investment position of the US". She also stressed the inequity bias of the current international monetary system, requiring emerging economies to self-insure, both due to fluctuating terms of trade and volatile capital flows. Instead of borrowing to accumulate large foreign exchange reserves, she proposed, in the Triffin tradition, "to increase the role of the SDRs to fund IMF operations, in a countercyclical way, whilst simultaneously guaranteeing that the supply of SDRs reflects the additional global demand for foreign exchange reserves". Going one step further would be to finance all IMF lending with SDRs, thus making global monetary creation similar to how central banks create domestic money, a very Triffinian proposition that RTI considers as the first best solution for the International Monetary System, as explained by the RTI working group on SDR[21].

21. Triffin International Foundation, "Using the Special Drawing Rights as a lever to reform the international monetary system", The Federalist Debate Papers N° 1, CESI Einstein Centre for International Studies, 2014. Also published in English/Spanish version by the Robert Triffin International Association, in International Monetary Issues n°2, ed. Versant Sud, Brussels, 2015

Alfonso Iozzo, Vice Chairman of RTI, referred also to the current system as the "International Monetary Scandal". In parallel with the Juncker Plan at the EU level, he advocated at the global level a recycling of the surpluses of the advanced countries in the form of investments in deficit developing countries.

In his view, the multi-currency system represented a transitory phase. We are moving towards a system with three major currencies, all of them being part of the SDR basket. Fortunately, the US Congress had ratified the change in IMF quotas before the end of the Obama Presidency. Also the inclusion of the Renminbi into the SDR would not have been possible without the support Obama. This was a legacy on which it would be impossible for President Trump to go back. It was important to exploit the situation created by the quota change and the enhanced composition of the SDR. He also strongly supported Buti's call for a stronger and unified EA representation in the IMF. In his view, the challenge in the future would be not only to preserve multilateralism but to move from multilateralism to supranationalism.

Reacting to these comments, Marco Buti was more ambivalent about the wider use of the SDR. The inclusion of the Renminbi in the SDR was a positive development but it was only a measured step as the foundations of the Chinese capital markets still needed strengthening. The inclusion of the Renminbi was part of an evolutionary trend, a transition period for the SDR which would need to be managed. It would provide more opportunities for diversification. In the meantime, the IMF would need to concentrate on the policy coordination challenges and the consolidation of the multilateral safety nets both at the regional and global levels. Fortunately, the Federal Reserve was willing to help emerging countries with swaps. In the EA, completing the Banking Union and the Capital Markets Union was a key condition for recycling the surpluses of Germany and the Netherlands towards the EA deficit countries. However, the EA as a whole would remain in surplus as a result of imbalances in the US policy mix and other trends at global level.

As concerned the external representation of the EA, there was a massive resistance of the Member States to the proposal of Commissioner Moscovici to have a unified representation of the EA in the IMF. Bureaucratic vested interests and inertia were still prevailing. A less ambitious proposal, which would send a powerful political signal, would be to start by unifying the French and German representations.

Currently the EU had more open issues with China than with the US. We were still in a learning period with the US Presidency. The jury was still out.

A participant (Gary Cohn) expressed concern that the world was becoming a market place where everybody wanted to work only for his/her advantage. Transactional approaches and zero-sum views appeared to prevail. Values were ignored. He asked also what were the priorities for the EU. Marco Buti answered that, despite a difficult environment, unprecedented steps in policy coordination had been achieved since 2008. For the EU, the priority was to safeguard the EA. But he agreed that in the future, Europe had to count more on itself.

Reform of the International Monetary System and new global economic governance: how the EU may contribute

Brussels, 6 June 2017, Jean Monnet Network kick-off event and Triffin Annual Lecture 2017

The Jean Monnet Network "Crisis-Equity-Democracy for Europe and Latin America" is a research project selected and financed at 80% by the European Commission and for the rest by a consortium of six academic institutions from Europe and Latin America (Hellenic Foundation for European and Foreign Policy, ELIAMEP/Crisis Observatory, Greece – Institute of International Relations of the University of Sao Paulo -IRI USP, Brazil – Interdisciplinary Institute for Relations between Europe and Latin America and the Caribbean, IRELAC, Brussels – Istituto Affari Internazionali, IAI, Italy – PUC-Rio, Pontifical Catholic University of Rio de Janeiro, Brazil – University of Vienna, Austria). The project is coordinated by IRELAC. The kick-off meetings of this research network was organized with the active involvement of the Robert Triffin International Association – RTI/UCL and the support of the GUTT Fund/ULB, the Caisse des Dépôts et Consignation – CDC (Paris) and the Royal Egmont Institute. These kick-off sessions were held in June 2017 around the "Annual Triffin's lecture" dedicated this year to analyse global disequilibrium and how significant Europe's role has been in shaping the new global governance.

The main reason for launching the Jean Monnet Network on the global crisis in the framework of the traditional Annual Triffin's lecture is the need to start from identifying the most global and deepest issue that affects all the regions: the dysfunctions in the international monetary system (IMS) and the still acting "Triffin dilemma". Indeed, the present IMS based upon the use of the US dollar as the main international reserve currency introduces necessarily an asymmetry which feeds important spillovers on the world economy. This "built-in destabilizer" produces big liquidity waves with important effects on the monetary policies in the rest of the world but also on the US federal reserve. The present difficulties of the global economy and the challenges that Central Banks are facing with the effects of their quantitative easing measures and how to get out of them are also a result of the flaw of the IMS which impedes a rational control of global liquidities. The purpose of the Triffin's lecture was to examine how Europe could act through the present global governance to improve the situation.

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