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GLOBALIZATION OF THE MONETARY SYSTEM

Abstract

The article disputes on future development of the international monetary system under conditions of modern globalization. The author asserts that globalization is an objective process, and thus, the international monetary system continues its logical development from the universal money commodity equivalent (gold) through multiple reserve (international) currencies back to the world money of higher order. The intermediate stage of this process can be the creation of target currency zones with leading currencies, one example of which is the single European currency – the Euro. In this context, the question about further development of monetary systems of separate countries (including Ukraine) takes on special importance.

Key words:

Globalization, monetary system, demonetarization of gold, target currency zones, International Monetary Fund.

JEL: F33; G15.

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Introduction

Globalization has many aspects, but the significance of its economic component does not seem to raise any doubts among the researchers of this phenomenon, even more, it often appears oversized or hypertrophied in the eyes of beholders. The proliferation of monetary relations onto the new areas of human relations, primarily in the patriarchal and semi-patriarchal societies (where such relations are brought in from the outside and very often – from beyond the country's borders), is treated not only as a tool, but also as a reason of crashing conventional socio-economic, political and cultural relations, their fitting to the standards of the industrially developed nations – that is, the globalization of the modern world.

Anyway, this process is absolutely objective, since the money lying in its heart, by its nature of an economic category, carries the whole globalization process in its germ, only one stage of which (although a very active one) is exposed to our view today. The scientific analysis of the genesis of money gives evidence that, since its very origin, the money – as materialized social relations – was meant to provide technical facilities for trade and economic relations being established among different communities (tribes, nations, states). Consequently, its already qualitative development (from measure of value to means of payment and further – to the world money) demonstrates a clear tendency to globalization of monetary relations.

As it is known from the history of money, its role was initially performed (though in primitive, underdeveloped forms) by various commodities of high value to specific human communities and of high internal demand: cattle, pelt, furs, bars of green tea, kauri shells, etc. Nevertheless, acting as a technical means of exchange among members of such communities, these quasi-money commodities could not perform the same function in other communities, where they were not of equal value and not in similar demand. Gradually, however, metals have become the money commodity in different societies (the demand for metals was caused by the development of productive powers and production, in the first place craft industry). Later, out of many metals, only the precious ones were separated; finally, the gold, whose known natural properties (divisibility, homogeneity, durability, and not lastly – its bright colour) allowed it to become the full-valued money. «Gold by its nature is not money, but money by its nature is gold» – this is how the Marxist economic science summed up the process. Incidentally, the development of money as an economic category is still going on.

Although gold is a value equivalent, thereby being a measure of value, an important property of money is not its ability to measure, but to *co-measure* different values. At the present stage of market economy development, it is not impossible in principle to set prices by means of credit money, even if we assume that humanity has somehow forgotten all ratios of exchange set earlier by means of gold money. Moreover, there is not a slightest need for using gold in pricing if such ratios have already been once set with its help.

Under present conditions, gold has not obviously lost its ability to perform its function of a measure of value, since the properties that allowed it to perform this function before have not undergone any changes. However, significant changes have occurred in the external conditions of its functioning as money, which have deprived this yellow metal of the *opportunity* to act as a measure of value. In other words, in the modern market economy, the capacity of gold to act as the measure of value is a formal, not a real capacity.

In the past, gold payments were considered final since the creditor received an equivalent value of goods and services which he had previously supplied to the market. However, in view of the fact that the value received was usually not the consumer value directly required by the creditor, it was important that he receives the equivalent of the exchange value. Thus, it has become possible for credit money to act as a means of payment because it became the measure of value and the basis of price formation, as well as the means of circulation. In other words, under modern economic conditions, credit money becomes an independent means of payment, since the entire evolution of production relations turns it into an exchange equivalent, the receipt of which is the essence of any payment as such.

Finally, if under the gold standard the accumulation of real gold money generated the creation of wealth («in- and out- channels of money circulation») serving as a mechanism of regulating the volume of money in circulation, under the modern conditions such regulation is performed by means of real credit money accumulation. Thus, the wealth-creating function has ceased to be the function of money, whereas the money's function of creating reserves of the means of circulation and payment stands out in its direct form (one might say «having taken off its golden garments»).

All these deep changes in the functions of money have gradually led to demonetization of gold in both separate economies and the entire international currency system, which was of significant importance for providing real opportunities for further globalization of the world economy.

Demonetization of gold – its complete loss of a monopolistic commodity equivalent stand, the termination of *all* its money functions, the negation of full-fledged (i.e. having its own value) money – has become reality long time ago. This process has collapsed at the beginning of the last century, which marked the transition to a new stage or surge of globalization, the most intensive stage of which is being observed at the moment. It was just that transition that urged the required changes in the basis of monetary system, including:

- *the separation of price formation from the gold base,* which has shown itself in a continuous price rise – the phenomenon practically unknown in the economy of peaceful times (the price rise could not be explained by a change in the ratio between commodity value and the value of gold as money);

- *the removal of gold from circulation,* which has initially been taking place spontaneously, alongside the introduction of paper and credit money, and finished for the most part during the World War I (only in the USA the completion of this stage was connected with the depression of 1929-1933);
- *the elimination of all forms of payment in gold* at the internal markets, which occurred together with the failure of gold-bullion and gold-exchange standards;
- *the breaking-up of the direct relationship between the volume of central bank's gold reserves and the volume of money emission***,** in result of which wealth ceased to be the in- and out- channels of money circulation both directly and indirectly;
- *the use of reserve currencies and international units of payment,* which have gradually crowded gold out of international circulation;
- *the appearance of a double price for gold* – the market one and the official one, *which after the crash of the so called «gold pool»* (1968) have begun to diverge increasingly from each other, finally leading to suspension of international transactions with gold;
- *the refusal from exchanging dollars into gold* even by the central banks (by President R. Nixon's decision of August 15, 1971), which has commemorated the crash of the final form of limited gold standard – the gold-dollar standard;
- *the elimination of gold parities,* i.e. the liquidation of official price for gold and the legitimization of floating exchange rates realized in 1976 at the Kingstone Session of the IMF Interim Commission – as a solely formal approval of the demonetization of gold.

At the surface of deep economic phenomena, this process was reflected in the structural evolution of the world currency system.

For the first time in the modern history, the world monetary system was legally established at the 1867 International Conference in Paris, although in fact it has originated in 1816 – when the gold-coin standard had been introduced in Great Britain; it has gradually spread thereafter to other countries and actually finished its formation in 1900, when the United States of America transferred to the gold-coin standard. The Paris currency system was distinguished by the fixed gold content of national currencies and gold-parity based exchange rates, as well as circulation of gold coins, free exchange of banknotes for gold coins at par value, and free exports and imports of gold (which under the «gold points» mechanism allowed to stabilize the exchange rates). However, the Paris system survived for several years in total and actually stopped functioning with the outbreak of the World War I and introduction of various restrictions by the governments of belligerent countries (e.g. ban on gold exports, termination of free exchange of banknotes to gold, etc).

Having not realized the true reasons for the crash of the gold-coin standard, after the war there was an attempt to revive it, which was the main aim of the Genoese International Economic Conference in 1922. However, this aim was not reached due not only to negative consequences of the war, but also to the economic conditions that underwent significant, principal changes (e.g. monopolization of production and distribution, rapid development of the financial market, internationalization of economic relations, increased economic role of the state, etc). Therefore, the new, Genoese monetary system, which has still been outliving the 19th century situation and the temporary refusal from the classical gold-coin standard, from the very beginning had been playing the role of an intermediary link in the chain of the world monetary system's evolution. The presence of the two qualitatively different approaches (gold-bullion and gold-exchange standards) within the system, as well as the attempts undertaken by one group of countries (the so-called «golden block» led by France) to return to the pre-war scheme as soon as possible, at the time when the USA and some other countries have entirely prohibited private ownership of monetary gold and have been fully employing the Keynesian recipes of inflationary support for economic growth (which in no way presupposed the «golden shackles» for the money emission), – all this contributed to tries to radically reform the Genoese system. The same tries have started to be undertaken back in the 1930s, but because of the World War II it has become possible to realize them in practice much later to complete the process at the Bretton-Woods International Conference in 1944.

Bretton-Woods Foundations

Bretton-Woods Agreements are the foundations, on the shivers of which the modern world monetary system rests. Thus, they should be looked at more closely.

The theoretical basis for the new international financial order laid the two plans developed by the British economist John Maynard Keynes and the US Deputy Minister of Finance Harry D. White. The plan of J. Keynes stipulated for the establishment of an international bank – The Clearing Union, which would be able to issue its own currency that should have replaced gold (this was underscored by the currency's name – «bancor»[1]). Central banks should have sold gold to bankers, but could not have bought it back. The final version of the English proposals was issued in April 1943 under the title «Proposals on the International Clearing Union» [19: 39]. The plan of H. White was based on the idea of

[1] Bancor – abbreviation from French words for «bank gold».

the priority of state financial interests against private interests, and it was initially designed exclusively for the countries of Western Hemisphere (their needs would have been served by the established American Bank).The plan was announced for the first time in January 1942 at the Rio-de-Janeiro Conference of Foreign Affairs Ministers of the American countries. Nevertheless, later it was decided to broaden the scope of the plan, and in March 1942 it was published under the title «The Proposed Plan on Creating the Monetary Stabilization Fund of the United and Associated Nations and the Bank of Reconstruction and Development of the United and Associated Nations» [19: 39].

The project on establishing this institution has been actively negotiated among allied states within the frames of the programme on establishing the system of international cooperation in the post-war world. As a result, the two plans were complemented also with a French alternative based on the 1939 French-British agreement. Unlike Anglo-Saxon proposals, the latter did not stipulate for the creation of any banks or clearing unions, neither it planned any dues to the fund or emission of any new currency. The main instrument of improving the international financial situation was seen by the French in the establishment of a more rigid currency control, which at the international level would be secured by a special institution – the Monetary Stabilization Office or International Clearing Office. In general, the idea consisted in yet another try to return to the gold standard [19: 43].

The subsequent common work has brought the positions of the two parties so close together that a common plan was published in April 1943, and yet in one year Washington and London published their joint declaration regarding the establishment of the International Monetary Fund. Thus, at the preparatory conference in the Atlantic City (June 1944), they have already been discussing secondary questions, like the choice of location for headquarters of the Fund and the World Bank. The final decisions were taken at the Bretton-Woods Conference.

Officially the International Monetary Fund was established in May 1946 (after appointment of the management board), but the first transactions were carried out only in March 1947 (this is why different sources date the start of IMF's work differently). The IMF's objective was fixed in Article 1 of the Articles of Agreement: «To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy» [6: 2]. «The IMF was created to prevent world economic depressions» [28: 145], – thus recapitulated the Fund's goals and objectives one of its high officials. «It is generally admitted that the Bretton-Woods system has been servicing the post-war world quite well, assuring stable conditions that allowed the international trade and payments to prosper… The American hegemony in the international monetary system has established itself naturally and remained beyond any doubt for fifteen years after the war» [23: 268].

The Fund originally concentrated its activity mainly on the industrially developed countries. The first problem to be solved by the IMF was the security of currency convertibility. Since the many years' tries to return to classical convertibility of national currencies into gold during the interwar period have failed, the new rules aimed at preserving that convertibility specifically for the American dollar (the so-called «gold dollar standard»). More precisely, the US Treasury obtained the right (but not obligation) to sell gold bullions to official financial institutions of other countries (central banks, treasuries, currency authorities, as well as several commercial banks authorized to perform currency regulating functions). «Without a gold peg, the dollar could hardly have played the roles of the international means of payment and international reserve unit, as well as it could not have been used as «an anchor» for all other capitalist currencies» [1: 44]. Besides the USA, only Canada and several small IMF member countries (mainly Central American) and Switzerland were willing to assume even the responsibility regarding the mutual convertibility of currencies in current operations (as it had been stipulated by Article 8 of the Agreement) [8: 87]. The industrial countries managed to resolve this problem only in late 1960s. For comparison, we should note that the Eastern European countries in transition have solved that challenge with lightning speed, in 3 to 4 years, some even faster. According to the Czech Minister of Finance V. Klaus, it sufficed only to declare convertibility in the early 1990s [9: 48]. However, such conditions were created thanks to a longstanding «tuning» of the world monetary system, where the IMF has certainly served its purpose. The newcomers had to introduce current convertibility at the time when other IMF members faced the problem of securing convertibility already under the capital account (which was formally not requested by the Agreement).

The evolution of currency convertibility has drastically changed the role of gold. The agreements about the new international monetary system were initially based on gold, primarily to impose at least some restrictions on the dollar and «to subject the USA as well to the balance-of-payments discipline» [2: 85]. The US gold reserves exceeded by much its dollar liabilities.

The Bretton Woods system was well thought-out and effective, but as far as its inner logic has corresponded to the real conditions of the world economy and fitted in the paradigm of the latter. The reconstruction of the European economy, the collapse of the old colonial system, the expansion of transnational corporations – all this were not merely quantitative, but qualitative changes in the system of world economy. These changes insistently called for the reformation of the monetary system.

Active (or if you wish, expansive) international policy of the USA has led to obvious misuse of the facilities for balance-of-payments deficit financing provided by the Bretton Woods system. As a result, the post-war deficit of international liquid means of payment or so called *«dollar gap»* was replaced in 1960s with their enormous surplus or «*dollar glut»*. This gave rise to the «Triffin dilemma»[2], the solution to which was recommended to be the creation of a new reserve unit, which would allow the USA to curtail its balance-of-payments deficit without having the development of the world economy decelerated in result of deficient liquidity. «A fundamental reform of the international monetary system has long been overdue. Its necessity and urgency are further highlighted today by the imminent threat to the once mighty US dollar», – declared R. Triffin in November 1960. The subsequent events have actually unfolded according to the anticipated scenario: the collapse of the «gold pool» and the double price for gold, the creation of the prototype world money in the form of SDR[3], French attack on the Fort-Knox reserves, the cessation of dollar-to-gold exchange for official institutions, and the semi-legal (in contravention of the Breton-Woods principles) practice of «floating» exchange rates. The stabilization in this sphere set in only after considerable changes in the «rules of play», which were reflected in the amendments to the Agreement on IMF (IMF Statute) in January 1976 (the so-called Jamaica or Kingstone exchange system). The gold was officially demonetized: gold parities and settlements in gold were abolished. The idea of «floating» exchange rates was completely legalized. Thus, the struggle for determining the «correct» fixed exchange rates seemed to pass into history. The fact is that back at the stage of preparing the Agreement, J. Keynes stood up for the nations' right to more flexible exchange rates, whereas H. White defended the idea of their stability, when a change in an exchange rate (mostly devaluation) should have been viewed as an extreme measure [2: 75-76]. Eventually, 1950s and early 1960s passed under the badge of the struggle between «for» and «against» devaluation sought to be used as a means of settling the balance-of-payments problems. Yet back in 1953, M. Friedman has classically argued the need for introducing a «floating» exchange rate system, since he believed that it were just the fixed exchange rates that urged the introduction of restrictions on trade and currency transactions.

[2] The American economic scientist R. Triffin in his speech to the US Congress in 1960 explained the fundamental problem of the world monetary system: «On the one hand, if the USA stops financing the balance-of-payments deficit [in dollars], the world community will lose the greatest source of additional reserves. The lack of liquidity arising from it will push the world economy into the compressive spiral, which leads to instability. On the other hand, if the [balance-of-payments] deficit of the USA will continue to increase, the persistent flow of dollars will continue to support the world economic growth. However, a huge deficit («dollar glut») will destroy the confidence in the value of US dollar. With no confidence the dollar will not be accepted as the world reserve currency. The system of fixed exchange rates will collapse, which will lead to instability» (See: R. Triffin. Gold and the Dollar Crisis. – New Haven CT, 1960).

[3] At the suggestion of French experts, the new reserve asset was named as a not immediately understood euphemism – «Special Drawing Rights». The SDRs were approved at the IMF's annual supervisory board meeting in 1968, and the relevant amendment to the Agreement on IMF came into effect on July 28, 1969.

The World's Modern Monetary Non-System

Rephrasing the known W. Churchill's expression about democracy, we can say that the modern monetary system is the worst one, if to disregard all others that have ever existed. In fact, not all experts agree with this. In March 1997, in his lecture at St. Vincent College (Pennsylvania, USA), the Nobel Prize Winner R. Mundell said: «The international exchange system in the exact meaning of this word does not exist». Nevertheless, the Kingstone non-system has started to be spoken about just after the agreement on changing the IMF's Statute was reached in 1976[4]. But those alarmed appraisals can hardly be taken seriously. Does it mean that the Paris system, having no formalized international rules and no supranational institution, existed? Did the Genoese system manage with only one Basel Bank for International Settlements (while its main function consisted in serving German reparations)? Was the Bretton Woods system complete with several dozens member countries in the IMF (even without such super-heavyweights as the USSR and China)? Yet, the Kingstone system can not be considered as such despite scrupulous regulation on the side of the IMF, which numbers about two hundred member countries (including all large economies and states), despite numerous international institutions that duplicate or complement the IMF's functions in the monetary sphere, from Basel Committee to Financial Stability Forum. Moreover, the system's terms of functioning are detailed in the Statute of the International Monetary Fund. Yet, this just may be the reason for such a sceptical appraisal. After all, the same R. Mundell has further explained his idea: «Each country has its own system. The currencies had been pegged to either precious metals or to other currencies for thousands of years. Now, already for a quarter of a century, the countries are forsaken». What is meant here is that the new system is based on a principally new paradigm compared to the previous ones. If the latter assigned some role to gold – be it the real money or at least the numéraire of different currencies – the modern system is more likely to suffer from the «golden appendix» of official gold reserves, which amount to 35 thousand tons, remaining some kind of atavism that only hinders the normal functioning of the world economic organism. To explain this thesis, let us turn to the theory of money circulation.

The Professor of Moscow State Institute of International Relations O. Butorina believes that the successive changing of four international monetary systems included two parallel processes: the removal of gold from circulation and the transfer of monetary leadership from one currency to another. The first case concerns the evolution of the money itself, whereas the second one is about using national currency as the world currency. We can principally agree with this statement. However, the classification of changes depends on how deep into the evolution process we are looking. We should understand that the

[4] See, e. g. T. de Vries' article «Jamaica or Non-Reform of International Monetary System» in the April issue of the *Foreign Affairs*, 1976.

«removal of gold» has started long before the gold standard was established and formalized at Paris Conference. The revolutionary act in this respect was the creation of the Bank of England in 1694**,** which in following the Robert Peel reform has gradually switched to discretionary money emission (which today is recognized as the basis for modern monetary policy). Already under the Bretton Woods, the «golden shackles» of emission remained only for the dollar, while Kingstone signified the final transition to a principally new system, where the money's own value was not the ultimate necessity[5]. It is only needed that in the process of exchange it holds a certain proportion to commodities, i. e. that it has an exchange value. However, it could historically have taken place only under condition that such a proportion was determined by the real correlation of values. Thus, the money itself should have had value. However, as soon as the circulation of gold as money was limited, its value lost its effect on pricing. This phenomenon has occurred everywhere after the paper banknotes ceased being exchanged for gold. The value of paper money servicing the commodity turnover broke away from the value of gold. How could it have happened? According to the law of value, the sum of the values of commodities in circulation equals the sum of their prices. Consequently, the sum of commodity values subject to exchange equals to the mass of money, which function as the means of circulation (taking into account the velocity of its circulation). Therefore, the value of money in circulation should be equal to the value of commodities in circulation. However, commodities circulate in order to be eventually exchanged for other commodities, not money. Hence, it appears that from the standpoint of commodity circulation, it is important that the money in circulation *represents* the value equivalent to the value of traded commodities, but not necessarily that it *has* that value. This is something that allowed replacing gold with simple paper notes, which have also become a *special* commodity.

This commodity is a direct embodiment of value, since its consumer value consists in its ability to represent exchange value. The «value» of paper banknotes was equivalent to the value of gold, whereas the value of the latter was always equal to value of traded commodities. Thus, the «value» of paper money was equal to value of commodities with the only peculiarity that it was congruous with the value of gold being replaced in circulation. As soon as the mechanism which supported this triunique correspondence – the free exchange of paper money to gold – is suspended, the «value» of paper money starts to deviate from the value of gold (the supposed content of which in a monetary unit is still being fixed for some time without having any real meaning), but holds equal to the sum of values of commodities. This happens for that simple reason that the value of gold, as well as of any other commodity, is determined by the social labour used to produce it. At the same time, the «value» of money is determined by absolutely other factors. However, as long as gold functions as money, the value of a respective bullion unit of «yellow metal» as a regular commodity determines the «value» of a monetary unit. Consequently, the total value of golden

[5] It is notable that on January 11, 1976, *The Financial Times*, when presenting the results of Kingstone Conference, titled the article «Gold Has Been Completely Demonetized».

money in use is adjusted to the sum value of commodities by changing the amount of money in circulation (which at one moment disappears in wealth, and at another, is pushed out by it again). After suspension of turnover, the value of money material halts its pressure on the «value» of monetary unit. Thus, the value of credit-paper (under modern conditions – credit) money is nothing else than an exchange value of all commodities. As before, the sum price of commodities equals the sum value of commodities. Yet, the mechanism of achieving such an equality relation has been radically changed. If earlier on the side of money circulation it was achieved exclusively thanks to the wealth mechanism – that is, at the cost of changing the amount of money in circulation, – under modern conditions both elements – the number of monetary units in circulation and the value of a monetary unit – become elastic. Thus, it turns out that now **any amount of money in circulation is necessary and normal**[6]. (One cannot but recall B. Spinoza's words that «the best quality of money is its quantity»). The understanding of this new foundation of world money circulation not merely explains the inevitability of continuous inflation – the nature of which goes on radically changing unexplained by classical theories (take, for example, the phenomenon of «stagflation») – and the fluctuations of exchange rates (considered as crises under Bretton Woods), but also allows to understand the logic of the current world monetary system.

Thus, the rejection of the two fundamental principles of Bretton-Woods Accord – (i) the convertibility from dollar to gold at a fixed price and (ii) fixed exchange rate of all other currencies to dollar (which, by the way, was achieved in action by fixing the currencies' gold content, although in reality the «dollar content» was meant) – broke the backbone of the old monetary systems. (It is clear that it has been broken in development and globalization of the world economy, whereas the amendments to the IMF Statute only recorded the *status quo*). The new monetary system reflected a complete victory of the credit type of money in domestic circulation of separate countries. The principle of discretionary emission, as a matter of fact, has remained non-alternated. The «currency board» emissions, being rather boundedly used, change nothing in the end, since the principle of discreet emission simply transfers from the national issuer onto the issuer of basic currency. In other words, the Currency Board is only a tool used to shift the formal responsibility for national currency circulation onto the foreign central bank.[7] In fact, it only escalates the country's economic problems (this was verified by the most advertised at the close of the last century experience of using this principle in Argentina). A similar result demonstrated the pegging of national currency to the dollar (although not so directly as in Argentina) in the countries of South-Eastern Asia. In Ukraine as well, the long-standing practice of

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[6] For a more detailed substantiation of the thesis see author's monograph «Эволюция денег при капитализме». – М.: Финансы и статистика. – 1990. – P. 23–28.

[7] For author's analysis of the role and place of the currency board system in the modern international monetary system, see «Матеріали науково-практичної конференції «Стратегія монетарної політики: Проблеми вибору та застосування». – Національний банк України. – 2002. – P. 187–190.

supporting exchange rate stability in relation to dollar has only accumulated the problems related to the terms of commodity exports and the monetary aspects of Euro-integration[8].

This indeed was stated in the rules of the Kingstone system, which essentially declared a new principle of regulation: «Permitted is everything that is not forbidden»[9]. Instead of the two Bretton Woods principles mentioned above, it was settled that the monetary authorities of the IMF member countries were, on the contrary, allowed not to peg their currencies at all, or to peg them to other currencies or to a «currency basket», or to adjust currency «floating» by any means **except pegging it to gold**. The economic liberalism lying at the heart of globalization processes has naturally laid the foundation for the world monetary system.

Quite another matter is that this freedom (as freedom in general) requires high degree of professionalism and social responsibility of monetary authorities, which has shown itself neither immediately nor everywhere. Thence appeared such cataclysms of 1970s-early 1980s as double-digit inflation against economic depression, abrupt fluctuations of exchange rates, chronic balance-of-payments imbalance, etc. The same as in the early times of previous world monetary systems, the international financial institutions and separate governments, having not yet perceived the principal changes, attempted to reconstruct, to reanimate the principles of the preceding system within the new one. Thence come, for example, a theoretical discussion and political struggle around the practice of floating exchange rates[10]. Exactly in this context one should consider, say, the Plaza Agreement (September 1985) and the Louvre Agreement (February 1986) about common monetary interventions of the countries of the «Group of Five» (in the Louvre Agreement joined two more countries – Italy and Canada) in order to maintain a motivated exchange rate of the dollar: at 2.5% deviation of exchange rates, the participants of the Agreement started voluntary unilateral interventions; whereas at 5% deviation – the interventions were multilateral and obligatory. Worth recalling is the fact that under the Bretton Woods Agreement, obligatory interventions or official devaluation/revaluation were realized at deviation of 1%. Therefore, those were pure attempts to establish a «soft version» of the

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[8] For a detailed analysis of this aspect see author's article «Monetary Aspects of Ukraine's Integration into the European Union». Journal of European Economy. – June, 2003. – P. 242–256.

[9] Such an approach means that the flexibility of system, orientation at continuous changes and self-improvement are at its very core. That is why at the cocktail party on the occasion of the IMF Kingstone Conference's end the US Finance Minister W. Simon with unconcealed self-irony said: «All is well that ends!» No one has clearly expected the end to changes in the world monetary system.

[10] We cannot help but draw an analogy with the outcries of «red dictators» around «broken economic relations» in the post-soviet space – the same misunderstanding of the objective reasons for failure of the system of old relations, which included administratively set procurement system or administratively fixed exchange ratios, and the focus on the attempts of its reconstruction, instead of elaborating a new mechanism at the proper time.

Bretton Woods system, which naturally failed just like the «gold pool» did in its time.

In the meantime, significant sectoral (regional) changes have started to occur in the system. Until early 1970s Western Europe was an integral part of the Bretton Woods system. However, the dollar crisis (not in the last turn caused by the policies of certain West-European countries, primarily France), collapse of the gold pool, establishment of two-tier gold market, and finally, the suspension of dollar-to-gold convertibility for central banks – all this forced the governments of the EU countries to search for a more safe place for their economies in the stormy ocean of money. The European monetary system became such a «harbour».

If not to advert to historical examples, one can say that the idea of the European monetary integration originated in R. Mundell's work «Optimal Currency Zones» published in 1961. In his paper, R. Mundell cited G. S. Mill, who viewed it barbaric for the nation states to try to preserve their national currencies, and made a conclusion that the «balkanization» of monetary systems (i. e. splitting of a large system into several small ones) makes it complicated for the money to perform its major function – facilitating trade relations and commodity turnover in general.

The first step towards common monetary system of the region was the emergence in April 1972 of the so-called «European currency snake» – the system under which the participating countries agreed to voluntarily restrict mutual floating of their currencies to 2.25% (above which the central banks were to make currency interventions or take other steps directed at returning the exchange rates into the set limits). The central exchange rates of the European currencies were examined every six months and adjusted as needed. Moreover, for almost a year (until March 1973) all member countries adhered to the 4.5% restriction on exchange rate fluctuations against the US dollar. Hence, the «European snake» seemed to wriggle in some kind of a «tunnel». After removal of the «tunnel» (i.e. the permission for a free float against American dollar), the «currency snake» has been in place for another six years (until March 1979). During this time it was realized that the existing mechanism could not work well between the countries with considerably different levels of economic development. In addition, the lack of common monetary organ also significantly affected the process of exchange rate regulation. As a result, on March 13, 1979, instead of the «currency snake» came the European Monetary System with its three main elements: the European Currency Unit (ECU)[11] , the exchange rate mechanism, and the European Monetary Cooperation Fund (EMCF) (in a way mini-IMF of regional significance). The EMS was formed by Germany, France, the Benelux countries, Italy, Ireland, and Denmark.

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[11] Its predecessor was the European Payment Unit (EPU) created in the mid-1970s, the value of which was first fixed in gold (0.888671g) and later – based on a «basket of currencies».

Another important change was a sizeable enlargement of the Kingstone Monetary System thanks to the countries of the former «socialist camp». The failure of the international socialist economic and, correspondingly, monetary system, which was based on the principles of purely administrative regulation[12], resulted in the appearance of a large group of countries with rather specific peculiarities. The development of their real economic sectors matched that of the industrially developed countries, but the absence or underdevelopment of market economy institutions (especially in the financial sector) made them equal to the countries until recently referred to as «the third world». This created additional problems and confronted not only the IMF, but also the governments and private financial institutions of other countries with new, urgent tasks. Aside from the need to provide post-communist countries with technical support to establish necessary market institutions, it was also a question of the risks related to investments in the economies of these countries (including investments in marketable securities and public stock), outflow of capital to the West, opening additional channels for money laundering, etc. Fast implementation of currency convertibility for current account operations of the «newcomers» has somewhat softened the process of their adaptation by the world monetary system (although created additional economic and social problems for the post-communist countries themselves). The EU accession of a wide group of post-communist countries has shifted the problems of currency adaptation onto the plane of further development of the European monetary area.

Gradually, the Kingstone monetary system has started to enrich itself with new features. In addition to change in the nature of exchange rate setting, a substantial difference from the Bretton Woods system was the liberalization of capital flows. From its very outset, the main statutory goal of the IMF member countries was to ensure current account convertibility of their currencies (A. VIII of the IMF Statute). It took industrially developed countries of the West more than a decade to achieve this objective. In 1976 – at the moment of Bretton Woods collapse – the current convertibility of national currencies was backed up by 41 countries. Today it is more than a hundred and fifty countries. Thence appeared new goals. Even today, the IMF Statute does not require of its member countries to back up their currencies' capital account convertibility. Meanwhile, it was just the transborder movement of capital and requirements of its liberalization that became elements of the modern monetary system. This very problem and the ways to solve it are becoming the focus of attention of the IMF and other world economic regulatory authorities. Finally, the development of information technologies has enabled the creation of a truly unique 24-hours' world money

[12] The author intentionally does not touch upon the functioning of the «transferable rouble» system and the idea of its convertibility that had been discussed before the collapse of that system. Although, in our opinion, the lack of such an analysis and understanding of the hopelessness of its development led to serious mistakes, such as, for example, the introduction in 1993 of the system of fixed, but in reality administratively-regulated, exchange rate of the Ukrainian currency. Unfortunately, the consequences of this step (which can be adequately described with Talleyrand's words: «It's worse than a crime, it's a mistake») have not been so far studied and analyzed.

market. However, this has not only simplified and improved the mechanism of currency transactions servicing commodity trade and movement of capital; this has also brought up speculative transactions (buying money for the money's sake) to a qualitative new level and supported rapid, irrepressible transfer of external shocks and financial crises from market to market, from continent to continent.

For many countries with emerging markets (as well as for the leading developing and post-communist countries), the consequences of currency liberalization have not always been solely positive, to put it mildly. In some cases, it has become the result of mere non-professionalism, inexperience, maladjustment of the entire economic system, or political inconsistency. Nevertheless, one cannot as well ignore the inadequacy of the world monetary system, its institutional and functional structures to the needs of all groups of countries, which leads to excessive dollarization[13], capital flight, and speculative pressure on the exchange rate of national currency. The Prime-Minister of Malaysia M. Mohamad stated it very explicitly in his speech at the World Bank annual meeting: «No one, I think, would want to return to the fixed exchange rates. But if anarchy is abhorred by good citizens everywhere, there is no reason why we should not abhor anarchy in the world financial system. A certain degree of uncertainty is fine, but an absolutely uncertain financial world is no good for anyone, except of course for those who deliberately create the uncertainty. (…) If trade is to grow, then currency values must be linked to the economic performance of the countries concerned. There are enough indices which can help indicate the value of the currencies, and the rates of exchange. A country that is doing reasonably well at a certain exchange rate should be allowed to maintain the rate. If the country is doing badly, devaluation can help the country, by making their costs lower and their products more competitive. On the other hand, if the country is too competitive, it is safe to assume that the currency is undervalued. Since many factors are involved, many rates are possible. Traders can then take the risk and trade in the currency, if they must. This way, there will not be a fixed rate, but the range of fluctuation will not be too wide. There will be enough uncertainty for genuine traders, but there will not be violent swings as to cause financial crisis for the country concerned. Trade would not be too disrupted and would in fact be enhanced, increasing the wealth for everyone. It would be a win-win situation» [10: 13]. Actually, for all logicality of considerations, the given situation is most unlikely to occur. The respectable Prime-Minister speaks of the economic relations typical of his own country, while tries to appeal to those who represent a qualitatively different economy. The trade as a driver of development has long given way to such sectors of economy as services, «knowledge economy», and investments. After the exchange rates broke away from the «gold anchor», they have lost contact with the «commodity anchor» as well: the exchange rate of currencies is no longer formed in the foreign trade. Exchange rate deviations from purchasing power parity have become so substantial and

[13] Here it is meant that not only US dollar, but other foreign currencies (more often Euro or Japanese yen) as well are used in the national money circulation.

long-lasting that one can no longer speak of the PPP as the foundation of exchange rate ratios. (The author abandoned himself to this idea already some 20–25 years ago). The growth of the world money market by order of 1–2 (up to almost 1.5trln dollars per day) in the fourth quarter of the last century has reduced the share of transactions servicing commodity trade agreements to 2 per cent. Whether one likes it or not, under conditions of financial market globalization, the formation of exchange rates and currency flows starts to follow other rules preconditioned by the task of optimizing savings and increasing the accumulated capital. That is why in the modern monetary system we can observe a synthesis of money, credit and investment markets. They are tightly intervened, and not only functionally, but also institutionally. The case in point is such elements of global financial architecture as, for example, the Financial Stability Forum.

In October 1998, the G7 Finance Ministries entrusted the President of Bundesbank H. Tietmeyer with a task of preparing a report for making recommendations on enhancing the effectiveness of cooperation between national and international authorities of financial supervision. Already in February 1999, the G7 Finance Ministers and top managers approved the submitted report and the recommendation to create the Financial Stability Forum. The first sitting of the FSF was held on April 14, 1999, at the IMF Headquarters. The Forum consists of the leaders of financial supervision authorities (ministries of finance, central banks, exchange commissions, etc) from 11 countries, where international financial centres are located (the G7 countries, Australia, the Netherlands, Hong Kong, and Singapore), representatives of IFOs (BIS, IMF, IBRD, OECD) and bodies of international control and regulation (Basel Committee on Banking Supervision, International Organization of Securities Commissions, and International Association of Insurance Supervisors).

The FSF's activity was largely predetermined by the fact that the long-standing institutions – the IMF and central banks – were no longer capable of producing an effect on the world monetary system with traditional instruments. Aggregate foreign currency reserves of the European central banks approach $500bn, while those of the US FRS are less than $100bn, which is incomparably less than the mentioned $1.5trln of the world's daily volume of market transactions. To tell the truth, the official gold reserves run up to $2trln, but the lion's share of it is concentrated in the countries of South-Eastern Asia (Japan, China, Hong Kong, Taiwan, and South Korea), which deepens monetary asymmetry even more, splitting the world into the countries-issuers of reserve currencies (USA, EU, Switzerland) and the countries-holders of reserves. Balancing between the two approaches to money-market stabilization[14] can somewhat delay

[14] These approaches could be called *«The rescue of a drowning man is the drowning man's own job»* (i. e. hoping for interventions from the side of Asian countries, which can themselves suffer from the next currency shock) and *«The onset of General de Gaulle»* (i. e. a modified imitation of French Government's attack at gold reserves of Fort Knox, but this time using American securities).

the collapse of the system, but by no means can it contribute to fundamental solution of the problem.

The central banks' manipulations with interest rates have also proven limited. This instrument cannot be claimed to be ineffective. Moreover, the attention of monetary authorities has been recently focused just at this instrument. Market analysts have been thoroughly monitoring the changes in interest rates on repo operations of the US Federal Reserve System, the European Central Bank, and the Bank of England. Yet, for the Bank of Japan, the interest rates of which are oscillating around zero, this mechanism fails. In the case of non-reserve currencies, the latter produces minor, short-term effect. For example, the Reserve Bank of South Africa has tried to use this instrument to overcome excessive appreciation of rand – its appreciation rates in 2002–2003 were the highest in the world, ceding in 2004 to Polish zloty. Despite the interest rates on the Bank's repo transactions have been gradually falling from 13.5 to 7.5 percent in October 2002 – August 2004, the rand's exchange rate has been continuously growing from 10.3 to 6.5 rand per dollar (later it has been growing at a constant interest rate).

Moreover, one cannot see the dynamics of exchange rates being directly influenced by the balance of payments, which should have come in balance due to changes in the direction and volume of financial flows in result of respective exchange rate changes. In most cases, a BOP surplus in countries with emerging markets does not bring to increased capital inflows, since under modern conditions much more important are the level of investor confidence (as for the country's political and economic stability) and development of financial market institutions in such countries. A considerable lag – and sometimes a gap – in this sphere between industrially developed countries and countries with emerging markets neutralizes the effect of automatic balance-of-payments adjustment, making it more vulnerable to subjective factors. It can be said, this process is de-economized. A characteristic example of it until recently has been the USA, whose balance-of-payments deficit was financed by long-term capital influx; and only such non-economic factors as terrorism suspended the effect of this established mechanism (causing much economic trouble, in particular in the area of exchange rate setting).

The mentioned changes naturally could not go and did not go unnoticed by the monetary authorities of separate countries or the core of the world monetary system – the International Monetary Fund, which is currently one of the largest (184 member countries[15]) and most renowned international organizations. However, the role and importance of this institution in the modern world economy is not equally appreciated. On the one hand, the IMF is traditionally viewed as a sort of supranational financial body; its functions are even demonized, portraying it as nothing less than the financial organ of «the world government». As M. Giovanoli has pointedly remarked on it, there is so far no single organ of the world financial power that would claim to establish the universal

[15] Zimbabwe's right to vote was suspended in June 2003 (according to A. XXVI, par. 2(b) of the IMF Statute), but the question about its exclusion has not yet been decided upon.

«rules of the game» and have control over them [18: 10]. As for the International Monetary Fund, it was created in its time as an organization designed so that its every member could rely on its temporary financing in case of balance-of-payments problems. In this connection, some experts even defined the IMF as a kind of a «credit union» [26: 2]. On the other hand, it would be a mistake to undervalue the importance of the IMF: it is not only the governments' biggest creditor, it is the institution that plays a very important role in harmonizing international monetary relations. Just to mention the fact that IMF member countries are free to regulate their monetary relations only with the Fund's non-members [5: 50] (though, looking at the Fund's current list of members, they'd better obey general rules of play). In addition, the IMF's assistance is not limited to finance as it also includes political advice, technical facilities, personnel training, etc.

Having been created to manage the system of fixed exchange rates, where all currencies were practically pegged to the American dollar, the Fund was forced to look for *raison d'etre*. This meaning was found in the need to coordinate actions directed at ensuring financial stability in the world. By letting the genie of free capital movement out of the bottle, the financial world gave rise to the greatest threat to its stability. Macroeconomic indices can no longer function as early warning signals of a coming crisis, since the latter emerges like tsunami (from the standpoint of old economic approaches) and spreads under the surface of financial markets to the most remote parts of the world. Thus, there appeared an objective need for «fixed monitoring stations» and a «rapid response centre».

The first serious signal for the IMF to change its objectives was the 1980s' debt crisis in Mexico and several other Latin American countries (primarily Argentina, Brazil and Venezuela) that announced their default. As a result, the depreciation of the Mexican peso reached 80%. Therefore, the Mexican crisis (as, previously, the Chilean crisis, which by different reasons has not drawn due attention) was characterized by a combination of bank failures and a disastrous fall of the exchange rate. The resulting threat to the leading banks of the West forced the governments of those countries to take immediate debt restructuring measures. The US government in the consortium with other OECD countries then issued a «bridge loan» to Mexico in value of $190bn [29: 9], which allowed to mitigate the debt crisis and shift it into the plane of accumulation of money for its gradual repayment. Like other governments of Latin American countries, the Mexican government increased taxes, cut government spending, limited domestic crediting, and encouraged exports. The monitoring of the named programs, as M. Feldstein notes [15], was delegated to the IMF.

The next signal was, again, the Mexican «tequila-crisis» of 1994-95, which rapidly spread to Argentina and Brazil. The economic models demonstrated that minor negative effects (shocks) produced on fundamental economic indicators can lead to a considerable fall of the exchange rate if the level of current debt (including debts on government securities and bank debt) exceeds currency reserves. Under such conditions, a many-sided equilibrium can be disturbed by a mere expectation that the government will ultimately default on backing convertibility of the national currency, which would immediately cause a collapse of the exchange rate. The proliferation of the crisis to Argentine and Brazil was also preconditioned not so much by the economic factors, as by the short-lived economic reforms and lack of their adequate testing, which provoked panic among the investors. Such investor behaviour was termed «moral hazard», coming since then into the everyday vocabulary of forex analysts.

In general, the recent years were characterized by serious aggravation of the financial crises problem. Recollecting the consequences of the 1931-1933 crisis, which made the US GDP fall by 4%, we cannot but comment that neither of nearly 100 crises with similar decline in GDP that occurred during the last two decades of the last century has led to such dramatic economic and socio-political outcomes. For all that, the governments and IFOs have learned their lesson in this time. Nevertheless, the mere fact that in 20 cases the GDP decline reached 10%, and in ten cases – 20% and more is rather troublesome. It might have seemed that the IMF was ready to face the crises of 1997-1998 and would succeed in performing its functions. However, – as showed the dispute between the noted American financier G. Soros and Malaysian Prime-Minister M. Mohamad (before the opening of the annual meeting of IMF and IBRD in Hong Kong on September 22, 1997) and the participants' reaction on it, – they had not learnt their lesson well. «We know now,» – stated Mohamad, – «that even as Mexico's economic crash was manipulated and made to crash, the economies of other developing countries too can be suddenly manipulated and forced to bow to the great fund managers who have now come to be the people to decide who should prosper and who shouldn't». He also mentioned that the answer of the IMF's Managing Director M.Camdessus to his letter, where he had asked to clamp down on big forex dealers (banks and hedge funds in the first place), essentially admitted the IMF's powerlessness against the latter. It was only four years later that the new Managing Director H. Köhler has put forward five theses that committed the IMF to work on improving globalization:

1. Issues of international interdependence demand more attention.
2. Globalization calls for international solidarity.
3. International cooperation and solidarity, however, should not weaken or, even more so, to substitute for national self-responsibility.
4. Although market economy by itself is the best mechanism of world economic coordination, we should still set the ground rules of participating in globalization.
5. We must respect the variety of experience and cultures so that the consolidation of international financial architecture does not bring to unification of all countries.

The modern world monetary system is substantially different from when it was passing from Bretton Woods to Kingstone. The first thing that comes to the front is rush development of a certain enclave – the island of stability in the ocean of floating exchange rates. The European Union has not only simply provided the majority of its members with stable exchange rates, but it introduced a common currency. The new stage in the EU's development was the programme on creating a monetary and economic union designed by J. Delors' Committee in April 1989. Already in 1990 almost all currency restrictions were removed within the EMU. The Maastricht Treaty of 1992 conceived not only the time of launching the common European currency (1 January 1999), but it also settled the criteria of membership in the European Economic and Monetary Union:

1. Average domestic rate of inflation should not exceed that of the three EU countries with the lowest inflation by more than 1.5%.
2. Government debt should not exceed 60% of GDP.
3. Budget deficit should not exceed 3% of GDP.
4. Exchange rate should stay within the normal fluctuation margin (without devaluation) for at least two years.
5. The average long-term government bond yield should not exceed by more than 2% the average of the relevant interest rates in the three EU member states with the lowest rates of inflation.

In 1994 the European Monetary Institute was opened in Frankfurt. Its task was to prepare the establishment of the ECB (European Central Bank). The Bank was created before 1999, and the reform started. On January 1, 1999, in all countries of the Euro-zone were introduced the exchange rates towards the Euro. During the transition period (1999-2001), the Euro was used in bank transaction along with national currencies. On January 1, 2002, the transition to the single currency was complete[16].

[16]The Euro-zone covered the EU countries, except Great Britain, Denmark and Sweden. Nevertheless, the zone *de facto* embraces more countries. Thus, the monetary unions between France and Monaco, San-Marino and Vatican resulted in an automatic entry to the Euro-zone of these «miniature» countries, which later «legalized their relations» directly with the EMU. Andorra, having no national currency and using the currencies of «states-patrons» (i.e. France and Spain) also automatically switched to Euro, having started negotiations with the European Commission as for the formalization of status quo only in May 2004. (In Liechtenstein, as is known, the legal means of payment is Swiss franc).
Some overseas possessions of France (Reunion, Guadeloupe, Martinique, and French Guiana) are formally part of the European Union, and the Euro-zone is automatically effective for them. On the other hand, the so called «collectivités territoriales», for example St. Pierre and the Mikelon Islands, are not part of the «integrated Europe», and although their legal means of payment was French currency, the banknotes nominated in francs were issued by the Institut d'Emission des Departements d'Outre Mer – IEDOM). The rejection of franc for Euro by the metropolis made France settle this problem separately.
The treaties on ensuring convertibility of domestic currencies into the Portuguese escudo at fixed exchange rates in the Cape Verde Islands, as well as those on convertibility into the French frank in the Comoro Islands and in the countries of Western and Central Africa (franc CFA) and French Pacific Ocean possessions, e. g. New Caledonia (franc CFP), are recognized by the European Union. At the moment, those Treaties guarantee the named countries the monetary union with the EU; at that, the responsibility (financial in

In addition to sectoral, functional and institutional changes, the world monetary system has undergone technological reforms. The interdependency of money markets has considerably increased in line with the development of communication and data processing technologies. The emergence of national Real Time Gross Settlement systems (RTGS) and later their integration into international financial networks (such as the EU's TARGET system) have also been reflected on the functioning of the world monetary system. After all, the rules of currency regulation and control should now take into account possible effects of operations not only on the national economy. The effects produced by operations carried out in geographically remote markets should be respectively taken into account as well. In fact, this interdependence was highlighted by the crisis of 1997-1998, which spread quicker than avian flu from South-Eastern Europe to Latin America and Russia.

Finally, the current system exists in fundamentally different political environment preconditioned by the collapse of the communist system, emergence and positioning of the new states, and intensifying competition between the USA and Europe.

This, as a matter of fact, is the outfit it is taking along into the future.

(To be continued in the next issue).

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the first place) for meeting the Treaties still rests with the governments of Portugal and France respectively.

Moreover, along with national currencies, the Euro de facto is used as a legal means of payment in Kosovo and Montenegro (only German mark had that status before), while Bulgaria and Bosnia-Herzegovina have their own «currency boards» based on Euro.

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