Global Public Goods and the Reform of the International Monetary System

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1. A common commitment for global public goods

There are a few doubts that climate change is currently a global public bad. Without concerted action by all humankind any attempt to stop global warming and reducing lethal carbon emissions cannot effectively affect the whole planet. The global nature of this and other public goods/bads and the problems associated with their production are well described in the economic literature. Public goods are usually underprovided: free riders are likely to emerge each time externalities are not fully internalized, and social marginal benefits/costs do not reflect private marginal benefits/costs.

While within nation-States (that match the administrative dimension in which policies can be enforced) this process of free riding can be effectively reduced, the production of transnational (public and/or merit) goods clashes with the usual problem of collective action. As unanimity or consensual decision is the rule in supranational decision-making, collective choices concerning the provision of global goods ends up being set below the required level.

Hence the question: is the current architecture of the international economic, financial, and political governance fit for the provision of the necessary amount of global public goods? In case it is not, does such architecture require only small adjustments or does it need a dramatic change in nature, scope, and structure? This note suggests that the latter is the correct answer, although the path towards reform is neither easy nor plausible in the current geopolitical framework; and that some steps to manage the transition towards such goal can be effectively implemented.

This issue is not new. It was raised several times in the past, since the emergence of widespread awareness of the global (or transnational) nature of some public goods, such as: resource constraints on growth in the early 1970s and again in the late 1980s; and financial stability after the 2007-08 financial crisis. The covid-related emergency further strengthened the perception that a wide-range of public goods are global in nature. During the financial crisis, demands for a major reform of the international economic and financial governance forcefully emerged in public debate and global institutions (Zhou 2009).

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At the G20 in London in April 2009 pressures were mounting for convening a Bretton Woods 2 conference, to reshape the balance of powers and redesign the governance of the international monetary system (IMS). On September 21, 2009, the UN Stiglitz Commission published its Report on *Reforms of the International Monetary and Financial System* suggesting new regulatory global institutions and a dramatic change of the nature of the economic and financial global framework.

In the meanwhile, suggestions were made for an increasing role of the IMF's multicurrency basket unit of account, such as an amended SDR to reflect the evolving balance of economic power in the world. The debate and proposals soon faded away, although pressures led to the insertion of the Chinese renminbi in the SDR's basket. The world had to wait until the covid pandemic to see the IMF issue the unprecedented amount of $650bn in SDRs in August 2021, six months before the Russian invasion of Ukraine halted any further attempts towards multilateralism.

Although the conflict froze concrete proposal towards multilateral governance of the international economic and political system, a renewed bilateral confrontation clashes against the need for global collective action and, sooner or later, a profound revision of the international system is needed. In this framework, we suggest that SDRs are a reasonable instrument to relieve multilateralism, especially if used to finance development and redistribution projects worldwide.

2. The potential role of the SDRs

The SDRs were the result of an intellectual struggle that lasted for a few years during the 1960s. Thanks to initiatives led by Machlup, Fellner and Triffin several groups of academics and policymakers reflected on possible reforms of the IMS in order to escape the so-called *Triffin dilemma*: the fact that international liquidity cannot be provided uniquely by an hegemonic country because, when demands for liquidity increase the only way to provide it is through domestic and foreign payments unbalance of the pivot country (the USA), thus leading to the end of convertibility (Triffin 1960).

The proposal to issue SDRs was therefore meant to supply a new, multilateral, liquidity instrument. SDRs were indeed first issued between 1970 and 1972 (during the historical phase that brought to the end of the Bretton Woods regime and towards flexible exchange rates) precisely to provide non-gold (whose supply is inelastic) and non-dollar (whose extreme supply elasticity undermines the credibility of the system) liquidity to the international economic system. US hegemonic interests determined, until recently, an under-provision of SDRs.

SDRs are a basket currency, now including (differently weighted) five major currencies: US dollar, euro, renminbi, yen, and pound sterling. SDRs are issued by the IMF and distributed to each country following the capital key rule: each country receives a share of the issue depending on its share in the IMF capital. This means that the largest recipient of SDR is the USA, followed by other industrialized countries, implying that unless some redistributive measure is taken, this currency cannot be used to promote development in underdeveloped or developing countries. But it can be used to promote the production of global public goods, assuming that the most advanced economies should contribute to their provision more than others.

When they were designed, during the Sixties, SDRs were thought of (also) as a source of potential financing to the economy, not as a mere reserve asset, and as a potential anchor to the international monetary system. Their current nature is still that of a reserve asset; but after the covid a debate emerged as to the means to transform this money into spendable liquidity, not just as mere settler of international payments.

In August 2021 this debate culminated in the issue of $650bn of SDRs and suggestions emerged as to the ways to use this money to support development, increase the resilience of financial safety nets in specific areas, etc. Many countries in fact do not need balance of payments assistance and would simply keep SDRs as a reserve asset, without letting them circulate in the economy, which is economically inefficient. Hence the emergence of proposals to channel such SDRs for reducing development gaps and asymmetries, and promoting sustainable goals (Plant 2021, Wolf 2021, Masini 2022).

One further step for their greater use would imply establishing a multilateral clearing for SDR operations, as was the case with the BIS for ECUs. This would pave the way to the private use of SDRs, assuming they are made convertible into claims held by central and private banks.

Let me add one remark on global liquidity and safe assets. We are living in an era of excess saving over investment, and these resources are channeled towards the only safe asset available worldwide: the US Treasury bond. This is happening also in this very moment, in which the US GDP is decreasing in global terms. This is leading to the impossibility for the US T-bond to keep pace with safe asset demand, the only viable alternative being euro-denominated T-bonds, that nevertheless are still a ridiculous share of global liquidity and meet ideological resistance to EU indebtedness, or an increasing role of the SDRs, so as to create a debt for the global economy, directed to the provision of global public goods.

3. From financial speculation to investment

One of the most pressing worries of economists and policymakers in the last years has been understanding why Central Banks (CBs) seemed unable to counter price dynamics, both deflation and inflation. The liquidity trap during the years of the quantitative easing before 2020 and the current inability to push inflation down seem to weaken the credibility of monetary policy as an effective policy tool.

Quantitative easing only resulted in an increasing financialization of the economy and an explosion of Central Banks balance sheets (Ghymers 2021). Most commentators underline how the *rush to the bottom* of interest rates, even negative in some cases, pushed markets to abandon long-term investment (with promising but late-coming returns), and prefer high-yield short-term speculation (de Larosiere 2022). In turn, this decreased aggregate demand, thus requiring new monetary expansions in the attempt to ignite growth. In a vicious circle that seemed to be unstoppable.

Following Wicksell's logic, market rates below the natural ones resulted in overinvestment; more accurately, in misallocated investment in hot money, until and (mostly) exogenous event took place. Skyrocketing energy prices and upset global value chains, exacerbated by the Russian invasion of Ukraine, made inflation suddenly rise. Accordingly, Central Banks were forced to raise interest rates, thus further weakening any perspective for long-term investment in the real economy and dampening projects with long-term returns on investment.

There are several flaws in this – today dominant – logic. The first is that only in a neoclassical perspective interest rates do play a significant role in investment decisions, while in a Keynesian perspective they depend on the marginal efficiency of capital: a highly unstable and unpredictable, subjective assessment by entrepreneurs of the relative role of the cost of debt and cash flows deriving from returns on investments. If future demand is high and stable, companies do invest, despite the (high) absolute level of the cost of money. As a counterfactual testimony of this Pangestu, Pazarbasioglu and Stern (2023) observed that despite declining interest rates in the last two decades, real/productive investments dropped.

When uncertainty about the future prevails, a portfolio reflecting subjective propensity to balance risk choosing zero-yield risk-free bonds with high-yield speculative assets is preferred to long-term productive projects. Declining investment in the real economy, especially in Europe, reflected the endogenous flaws of its economic and strategic governance, that relies on unanimity decision-making processes, therefore uncoherent with the other major global actors. Had a supranational European budget existed, it would presumably have followed the USA and other regional aggregates in implementing strategic investments, thus reducing the fragility of both the real and financial sectors.

This leads to the second flaw, which concerns the role of fiscal policy, usually neglected in debates on the effectiveness of monetary policy. Monetary policy may fail in pushing to produce specific supranational (merit) goods, but an ad-hoc policy mix of coordinated fiscal and monetary policy might be quite effective. Again, the governance of the EU is uncoherent with the need to take timely and efficient decisions. Is there any way out, both at the European and global level? We suggest that a special role, in this process, may be played by Multilateral Development Banks (MDBs).

4. Managing the transition: the role of MDBs

The provision of a few global public goods is key for the survival of humankind. And cannot be waiting for a new institutional architecture that implies a deep revision of the geopolitical balance of power in the world. Managing the transition towards such goals becomes crucial.

One key actor that may help revitalizing multilateralism, at the same time strengthening regional ties and promoting long-term development investments, are MDBs. Being financial institutions, whose shareholders are groups of nation States, MDBs do not directly represent global choices; but they are particularly fit for a few steps that might be taken immediately in that direction.

Firstly, they are all *prescribed holders* of SDRs. The IMF recently added five more MDBs to the list of institutions that are allowed to hold and deal with SDRs, making them the most powerful agent in a transition towards greater use of such currency in development projects.

Second, they are precisely devoted to finance investments related to real-economy projects, such as infrastructure. Third, they can mobilize private capitals, thanks to their solidity (being assisted by national governments for their collateral) and the return on investment that investment projects ensure; providing also a potentially efficient mediation between State intervention and market forces. Forth, being mostly characterized by geographical proximity, they allow for a better and more effective control, without the need to resort to strict and explicit conditionality rules, thus being more acceptable as a source of financing and more efficient in tackling regional spillover effects that usually characterize development projects.

Concluding remarks

The IMS needs profound reforms to face the current and forthcoming global challenges, that require a much more efficient structure than only relying on loose international cooperation. Enforcement and democratic legitimacy are urgent. As is manifest once again, once conflicts prevail over diplomacy, global public goods cannot be provided, and the world cannot afford delays in many areas, such as the struggle against climate change.

Pending a more radical reform of the IMS, we highlighted how an increased role of the SDRs as international money could help rescue multilateralization against bilateral confrontation. We also suggested that further channeling SDRs to MDBs might help strengthening regional integration and investments in the real economy, thus providing also a guidance for the sustainability of the increased CBs balance sheets.

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