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International Currency Conflict in the Contemporary World Monetary System

Mikhail Zharikov

Doctor of Economics, World Economy and World Finance Department, Professor; Institute for World Economic and International Finance Studies, Senior Scientific Fellow; Financial University, Moscow, Russia; michaelzharikoff@gmail.com; http://orcid.org/0000–0002–2162–5056

Abstract

The article addresses international currency conflicts. The research has found that currency conflict has extensive economic effects, especially on the United States and the weak peripheral countries of the Eurozone, as well as Canada, and some other countries that do not intervene in the currency markets. The author has revealed that these developments and ill-effects of global currency manipulation stem from a gaping hole in the international economic architecture. The theoretical significance of the article's outcomes is that the most fundamental flaw in the entire global regime encompasses both the monetary and trading systems, and indicates a massive failure of international cooperation. The practical significance of the paper is that it has outlaid a feasible set of effective systemic reforms that can be adopted to counter the objectionable practices today and deter them in the future. The author concludes that it is very much in the interest of all the world's countries to initiate a multilateral effort to work out a constructive solution to a significant international and systemic problem.

Keywords: international monetary system; currency wars; international monetary and currency conflict; foreign-exchange intervention; countervailing currency intervention; countervailing import duties; competitive currency intervention

JEL Classification: F37

The Origins, the Purpose and the Essence of International Currency Conflicts

The international monetary system faces a clear and present danger, the danger of currency wars. The reason for this is that virtually every major country is seeking weakening or at least non-strengthening of its currency to strengthen its economy and create jobs (Afontsev, 2009). In the world today, there are more than twenty countries that have been intervening directly in foreign exchange markets to raise the competitiveness of their products. It resulted in cumulative build-ups of foreign exchange reserves. They exceed 10 trillion dollars and averaging about one trillion dollars per year in recent years to keep their currencies weak and push other countries' currencies too strong with the comparative effects and economic effects for national competitive positions in the international marketplace. These countries do so mainly by buying dollars and euros, internationally used currencies, to keep those currencies overly strong and their currencies chiefly weak to boost their international competitiveness and trade surpluses. Most of these countries have continued this practice straight to the recent bout of unwelcome currency weaknesses in a few other emerging markets, and that makes the problem even worse (Avdokushin & Ivanova, 2014). The list of these currency manipulators includes some of the largest economies in the world, both developing and developed. This group of countries is, of course, led by China which has been the manipulator above all for a decade. It also includes some other Asian countries, several oil exporters and even a few European countries. The country that has practised this egregious behaviour accounts for almost one-third of the world economy, and two-thirds of global trade surpluses coming from their practices. China is thus the centrepiece of the international currency conflict (Anrdonova, 2012).

Currency Manipulation Effects

The currency manipulation and therefore the distortion of competitiveness between countries enables the manipulators to increase their trade surpluses by somewhere between half a trillion and a trillion dollars per year. When they do that, they create corresponding trade deficits in the countries on the other side of the equation. So, China, on the one hand, and the US on the other side, are having these massive trade imbalances in large part because of the currency manipulation (Chorev & Babb, 2009). When countries are adversely affected like the US, Canada, the Eurozone countries, they then run significant deficits. That subtracts their economic production and destroys jobs. Since all of them are primarily concerned with creating jobs in this period of relative economic weakness and prolonged recovery from the Great Recession, that is a grave matter indeed (Arner & Taylor, 2009).

The most significant loser in absolute terms by far is the United States. Its trade deficits, as a result, have been several hundred billion dollars per year larger. The US has also lost anywhere from one to five million jobs as a result. Europe is the second-largest loser with trade deterioration in the range of a hundred billion dollars. Results of some research published by the International Monetary Fund and the European Commission shows that the currency manipulation, particularly by the Asian countries (but also by some European countries like Switzerland), have been significant factors in weakening the economies of the weak states in the Eurozone such as Italy, Spain, Portugal and Greece (Beder, 2009). In other words, this currency manipulation, in addition to shifting vast amounts of production and jobs, has been a significant causal factor of the euro crisis which has brought the world close to a financial brink of collapse in recent years. On top of all this, the global trade imbalances and the currency manipulations as one of their major causes also played a central role in bringing in the global financial and economic crisis. It can be explained as follows. The trade imbalances reached their peaks back in the middle part of the previous decade, i.e. 2005–2007. At this point, the countries that were running these big surpluses had to do something with their earnings from those surpluses. When they have a trade surplus, they pile up reserves, and they have got the industrial reserves somewhere, most of them in dollars, some in euros (Braterski, 2011).

These countries invest their money in the United States. It had the impact of increasing the supply of money there, making it very difficult to tighten the monetary policy as the Federal Reserve wanted to in 2004–2005. It created a loose set of monetary conditions that both inflated the economy and weakened the incentive for financial regulation.

Of course, China and other countries piling up the surpluses did not force the US banks to make sub-prime loans and do the kinds of things that immediately produced the crisis. However, their currency manipulation played a central role in creating the economic and monetary environment for the crisis foundation. It has had devastating effects on the world economy as well as the United States as its epicentre.

These reserve build-ups and imbalances have declined a bit lately. China, in particular, has let its currency go up substantially and sharply reduced its trading surplus. But the Chinese currency remains substantially undervalued, including by enormous amounts.

Moreover, a lot of the reduction in the deficits on the US part, for example, had been caused by the Great Recession. In a recession, the demand for imports like everything else declines, the trade deficit falls, but that is a temporary factor. The IMF projects that these trading imbalances are going to start getting bigger again, and the problem is likely to rise further. China's reserves went up more than 150 billion dollars in the first half of the year 2019. It means they are intervening to the tune of more than one billion dollars per day in the currency markets while keeping their exchange rate weak. The aim was to keep US exchange rates strong and distort as a result of competitive positions. The latest estimates of exchange rates show that the Chinese currency would need to rise by at least 15 per cent on a trade-weighted average to eliminate these distortions. That means it would have to go by about twice that amount against the US dollar or the Canadian dollar and some of the other key currencies (Yefremenko, 2007).

The point is that they are massive imbalances. The international institutions worry about this. The G20 and the G7 have continued to invade against the global imbalances and emphasise again at their meetings to avoid exchange rate targeting. Brazil, in fact, has taken the issue to the World Trade Organisation but nothing much has happened.

The outlook suggested is most worrisome, because some of the world's largest and wealthiest economies have already joined or seem to be contemplating joining the currency wars. The world's largest currency manipulator in the year 2018 was Switzerland, a little country, but a big player in the world trade, one of the dominant trade partners of the European Union that has virtually pegged its exchange rate, kept it from going up against the euro, even though it is running the most prominent trade surpluses in the world at a time when its major trading partners in the Eurozone is in the recession. Japan did trigger the latest wave of concern. The new government very aggressively said that it wanted a weaker exchange rate for the yen. It used what is called in the business 'verbal intervention'. It drove the yen down 30 per cent against the dollar. That among other things enraged the US auto industry which competes with the Japanese automakers. But more widely it gave Japan an enormous leg-up in international competition. They subsequently adopted the policy of monetary policy expansion. It ratified what they had done before, but it was their initial intervention that had knocked the yen down (Chen, Milesi-Ferretti, & Tressel, 2012).

The President of France has called for a weaker euro. Some perceptive British observers believe that its officials have been suddenly talking down the pound. So, there is a lot of intervention occurring, big countries as well as small, wealthy countries as well as poor. It is a very wide-spread practice.

There should have been greater exchange rate flexibility in the world. One argument that one could make for greater flexibility is that it is actually in China's interest, not in the interest of everybody else. Look at the accumulation of foreign assets that are required to prevent the appreciation of the Renminbi, much of it is in low-yielding US Treasury bills, sitting in a sizeable huge stock of that, the prospect of the US dollar declining overtime. There is a considerable capital loss on the stock of assets that China is holding. China has been fairly effective in sterilising those inflows. However, it has not been perfectly purified.

One could argue again that China is now overdependent on export industries. Taking the huge stocks of foreign capital, sterilising it, putting it in the financial system, lower interest rates in China coupled with problems in the financial intermediation system in China. And they have potentially huge issues of misallocation of capital in China, and the exchange rate regime being part of the problem for that. Household savings in China are very high. Part of that has to do with the demographic situation in China and the ageing population or the lack of social safety nets in China. So, people are seeing low rates of return on their savings in financial institutions and then seeking other places to put their funds, including housing with the potential for housing bubbles to develop in China. One could credibly get the case that greater flexibility of the Renminbi is actually in China's interest, not only in the interest of the United States or other flexible-exchange-rate countries. China's latest five-year plan has basically recognised that it wants to move in that direction. Indeed, the Renminbi has appreciated by about a third over the last number of years (Chinn & Ito, 2008).

The second series of questions has to do with the economy and the political economy of the United States. How much of the manufacturing loss in the United States has to do with currency manipulation? A large part of it is due to currency manipulation. Another argument could be made that other countries in the world are just more efficient manufacturers of consumer goods than the United States. So part of the decline in those industries and the United States may be due to currency manipulation, but some of it could also be because other economies are more efficient in producing those goods.

The other thing is that the export subsidy of having a fixed exchange rate regime does have the effect of subsidising consumer goods in the United States and elsewhere. While there seems to be a strong coalition in the United States, what the impact would be in the United States when people realise that probably the outcome of all of this is now an increase in consumer goods that people have become used to in the United States at a certain price? Alternatively, one could see dealing with China as being a currency manipulator. But is that production going to shift from China to the United States, or is it going to shift from China to somewhere else? So, one does not see the gains that one might expect in terms of production in the United States itself. It comes down to a question of the political economy in the United States. China has been brilliant in terms involving itself in global supply chains. Despite a lot of foreign investment in Chinese enterprises, only about 50 per cent of export freights of goods in China is Chinese valued-added. It is value-added from elsewhere in the world that they put together in China (Dorrucci & McKay, 2011).

The other thing is that the savings are a subsidy for the rest of the world in terms of investment as well. Cheap savings have had a positive effect potentially in terms of investment elsewhere. Some of that investment, though, has to be done with strict financial regulation and very prudent regulation, or supervision of financial markets, but one could argue when they say that at least part of what has been happening with the Chinese situation is that they are providing cheap savings for investment elsewhere in the world as well.

The only point here is being not to deny many of the concerns that one raises, but there are also countervailing forces that would suggest that one has to think about what are the net consequences of it all.

Finally, there are perhaps more technical issues. Economists determine the equilibrium of exchange rate. There are many models. It is a difficult thing to do. The IMF itself has three models for exchange rates. What is the equilibrium exchange rate determination? One could leave this to the technicians and the econometricians. One has to be careful when one thinks of these kinds of regimes about avoiding substituting a degree of arbitrating a foreign degree of fairness. That would have to be done very carefully (Vaubel, 2018).

There are countervailing forces. Real, the US and Canadian consumers benefit from cheaper Chinese products because the Chinese are subsidising their consumption. That is correct. But they are also subsidising their job creation in much higher unemployment-area countries. So, they then have to make a value choice. It comes out of value judgement at the end of the day (Elyanov, 2009).

Many of the American firms have invested in China, and there are no problems with the Chinese government because they know that the Chinese government may retaliate against them. The Chinese government is adamant. When a country — be it the US, Canada or the EU — criticises them and predicts taking action against them, they will frequently retaliate against the companies based in their country. They will buy Airbuses instead of Boeings. So, the US companies are afraid, but they are very reluctant to attack the Chinese government. Besides, a lot of the American firms in China benefit from the underlying Chinese currency for the export competitiveness out of China.

Contrary to that the bulk of the American companies oppose what the Congress is now doing. And why the US has been so slow to act, this is one of the reasons, because the US companies have not been active at all in pushing the issue. China has been incredibly smart in taking hostages. They have opened to foreign investment in a big way. Incidentally, US investment in China is a tiny share of the total foreign investment in China — about 10 per cent. American firms are very modestly represented in China. When there is a significant policy issue in Washington, many of the American companies side with the Chinese. When Congress does what it has now suggested, it will do it going against the interest of the American companies. If the companies thought they bottomed, they would not buy very much. They lost now at least on this way. There are a lot of high costs to the US economy from the result. The most tangible cost is lost jobs because of Chinese currency manipulation (Sinn, 2014).

There have been lots of economic analyses that tried to distinguish between the volatility of exchange rates meaning bouncing around some more or less constant level and misalignments of exchange rates when they are at levels for long periods that do not accurately reflect underlying economic fundamentals. All the studies show that volatility is a minor factor in affecting trade flows and competitiveness, whereas misaligned levels are critical. The point in practical corporate terms, companies can usually hedge against the volatility. Most companies that are active in international business do that. One cannot hedge with total effectiveness of eight, ten years or more, but if one is talking in short to medium run, even to five years or so, there are foreign markets, there are derivative products of all types that can be used to hedge currency exposure. That protects against volatility, and most companies do that. That is a reason why the economic analysis then shows the minimal impact of volatility. Companies or individuals that have concerns could avail themselves of the hedging opportunities to banks, other financial institutions, and therefore be able to obviate the effect of volatility (Gourinchas & Obstfeld, 2012).

Eric Helleiner raised an excellent question about the motivation of the countries that build these reserve levels and intervention practices (Helleiner, 2009). The origin of the activity lies in the late 1990s and the early part of the last decade. It certainly reflects at least a substantial portion — the experience of the Asian crisis and subsequent crises in Brazil, Russia, etc., where countries felt they had inadequate reserves to defend themselves against being forced into austerity programmes and adjustment efforts by the IMF in terms of the Washington consensus that they did not like. In its origins, the policy had a lot of that element in it. However, the extent to which the reserve bills have occurred has not anything to do with that self-insurance motive. The countries that got a habit of running surpluses realised that export-led growth was something they both could get away with and would be cost-free domestic employment policy. There may be some countries like the Philippines and a few others who have built reserves and are still relatively weak and do not have vast amounts of reserves. They are not in the list of currency manipulators. But there are the ones that have reserves that way above what is generally viewed as needed. The IMF rule is a country should have reserves equal to three months of its imports. There is a much more conservative rule associated with Alan Greenspan that says a country should have reserved a hundred per cent covering its short-term currency liabilities. The countries mentioned massively exceed both those tests. That is the degree to which those policies have been carried in those countries that create the problem of international currency conflict (Griesgraber, 2009).

The foreign manipulators tend to invest very conservatively with a high emphasis on liquidity. Most of their investments do come in the US government securities, including short-term Treasury notes, Treasury bills, and a little bit longer-term paper, but most of it goes into government securities, which is one of the reasons that hold down the costs of borrowing to the government. It encourages the government to run significant deficits, even in periods of a boom when it should be running surpluses like before the crisis. The big US budget problem is really that the US went into the crisis with a lousy budget position. It had terrible boom management. When the economy was booming, they should have run surpluses. As early as 2000–2001 the US was running budget surpluses. If the US runs these significant surpluses for too long, the government would have to start buying private stock, and somehow the economy becomes nationalised. It was a ridiculous theory. It led to the Bush tax cuts, approved by Alan Greenspan. It put the US on the road to huge budget deficits when the economy was booming. So, when it went into the crisis when it needed stimulus spending, the country was in terrible shape. By contrast, China went into the crisis with big-budget surplus and therefore had lots of manoeuvrability and lots of room for credit to them. They did run their boom period economy very sensibly and prudently. As a result China did not go off the track like the US (Hankel & Isaak, 2011).

The currency manipulators should stop relying on significant trade surpluses and expand domestic demand. It has been agreed in principle by the G20 since it started meeting to deal with the crisis in 2008, that to get a sustainable world economy, there has to be a significant rebalancing. For the world it is impossible to have the US running substantial deficits, China running big surpluses, Germany running big surpluses, Japan running big surpluses. It is impossible to have a sustainable world economy with big imbalances of that time reflecting budget deficits of the type that the US has been running now for the last several years. So, as the US has to reduce its trade deficit, export more, invest more, China and other currency manipulators have to stop relying on foreign markets and expand their domestic markets, which most of them are in good position to do. There are reasonably large countries in Asia which as a group is a vast economy. They can export more to each other, but they have lots of opportunities to build domestic demand. China is expected to start serious reform actions, which would shift the focus of its economic development strategy away from foreign markets into domestic markets. Per capita income is meagre in China. Consumption is insufficient as a share of total national income (Schäffler, 2014).

There is an enormous opportunity for China, in particular, to shift away from relying on the export market to rely on the domestic market. They have got plenty of alternatives. They have enunciated and desired to go that way. What the world needs now are policy actions of which a number are entirely possible for the particular. This question is about consumer choice and the impact on the consumer. Since any economic variable has two sides to it, and the positive side of the Chinese manipulation for the US or Canada or any importing country is the cheaper imports. But the theory of consumer choice and the libertarian thinking that goes on around it, and the straight economics which frankly any economist believes in, market economics — all say that consumer choice is typically thought of as responding to market prices. And the problem with currency manipulation is that it distorts the market. In this case, it distorts the market in favour of the consumer, because the cheaper is the products from China or Malaysia or anywhere else, the cheaper they can buy at the Wal-Mart or some other store. But people do not usually think of that as a reflection of consumer subsidy, that the consumer is being subsidised by somebody, which is excellent for the consumer, but it has some very adverse effects on the other side of the equation. So, if one is thinking in terms of consumer sovereignty, consumer choice is typically articulated by this economic analysis and most political philosophy as well. It is consumers' reacting to market prices, not distorted prices. That is why it always seems that the people that ought to agree with the ought to be the most conservative and almost reactionary economists and politicians. It ought to be the right winners because they are the ones who put the great emphasis on the market and responding to market forces and avoiding big government intervention in the market. That is — about what the manipulation is. That is the governments of these manipulating countries injecting themselves into the market, distorting market prices for a government purpose, violating all the principles of libertarians and free-market economists, and those who frequently choose to be seen as conservatives on the economic spectrum. When a government of the size and power of China, Japan, Malaysia, Switzerland, any of the other countries that are on this list, inject their enormous resources into the market to distort prices that ought to be public enemy number one to the conservatives, and so it ought to be they on the right-wing who would be leading the charge against these practices (Jordà, Schularick, & Taylor, 2011).

The US Congress now is seized with the importance of the manufacturing sector and jobs in manufacturing, and that is what is being the driving force now in the political economy of the United States. The US is proposing some of the very robust measures in the international system to enforce that. The outcome is going to be what one is looking for in the United States. If it works out the system of international rules, it has got to be based on measurements of certain kinds, e.g. some metric that one can have confidence in that to have a system of international rules that the countries are going to apply (Robleh, Haldane, & Nahai-Williamson, 2012).

There is a growing sense that the adverse effects on the US economy outweigh the benefits, and therefore something has to be done about that. One of the elements is partly philosophical and partly political, and that is simply the element of fairness. International trade is supposed to be based on a series of widely agreed rules. The World Trade Organisation, for example, has got a lot of rules. It has got a dispute settlement mechanism. When somebody violates the rules to deal with, the WTO steps in. And that is why this currency manipulation issue is a massive gap in the international system because there are prohibitions against it, but there is no enforcement of that. So, in the US Congress and extensive parts of the society in the US, there is a sense of elemental unfairness that other countries including some large ones are cheating and violating the rules. They have not been called in the court for it. But they are still viewed as being cheaters. That is essentially where the debate is going now (Rousseau & Wachtel, 2011).

Counter-vailing Currency Intervention Strategies

The concept of defensive intervention enters the picture at this point. There are several countries whose currencies have become overvalued and pushed up by the practices described above and produced extra deficits for those countries. Those countries had to intervene defensively to keep their exchange rates from going up even higher pricing them even more and more out of their markets. That is justifiable because otherwise they would be pushed further into deficit, taking higher economic costs. Brazil has been a noteworthy case in point. New Zealand has done it recently. Australia and the United States, the biggest deficit country, have not done it, as well as the Eurozone (Griesgraber, 2009).

The systemic problem arises with the maintenance of significant and continuing currency under-valuations generated primarily through substantial and prolonged intervention. The global macroeconomic picture heightens those risks considerably. As a fiscal policy and budget policy are constrained, almost all of the rich economies are by substantial debt burdens. Most rich countries cannot expand fiscal policy to deal with their economic weaknesses. Indeed they had to tighten their fiscal policy because of budget problems. The result is widespread reliance on monetary policy, including QE — quantitative expansion in the United States, in Japan, and elsewhere. That reliance on monetary policy to expand economies has led the charges against the United States and Japan, the British and a few others that they too are practising competitive devaluation because when they expand money supply, they do issue interest rates that tend to weaken the currency (Reinhart & Rogoff, 2011).

The reason is that monetary policy is carried out for domestic purposes, with domestic instruments and in a way that has a spill-over in the currency markets, but it is primarily an internal policy device, whereas the intervention is directly in the currency markets aimed pure and simple at international pricing and national competitive positions. Nevertheless, if countries are on the receiving end of the reserve and capital flows like Brazil and some others, it looks like what the US is doing with monetary policy is not so different from what China is doing with foreign exchange intervention policy. Therefore one can be somewhat excused for conflating the two and throwing the defensive intervention too.

So, there are three different kinds of policy actions which are often conflated in public understanding and even the policy debate, all of which adds to the risk of currency conflict because it makes it appear that the problem is even worse than it is. The bottom line is that we have witnessed extensive competitive currency depreciation for several years, and the practice is widespread. Much more seems quite possible soon. The economic damage that has already resulted is immense and could become much worse.

It is worth noting that this is quite similar to what happened in the 1930s when a wave of competitive currency depreciations deepened and broadened the Great Depression. Indeed, many historians believe that it was the transmission of national recessions from country to country — England, US, France, Germany and back — that brought on the Great Depression and globalised the problem at that time (Kemenyuk, 2009).

When the architects of the post-war economic system got together to create the International Monetary Fund, the World Bank, the so-called Bretton Woods System, their central concern was to avoid a replication of that problem from the 1930s. And so they wrote steadfast rules into the charters of the IMF, the World Trade Organization or again as that was then to prescribe this kind of currency manipulation. Unfortunately, they failed to put any enforcement mechanisms into the rules. Though the rules were there, the implementation was absent at all, and the system has entirely failed to deter or respond to the practices described. It is a single most significant flaw in the entire international financial architecture. It is a failure to effectively sanction trade-surplus countries, especially to counter and deter competitive currency policies. Indeed, this systemic failure almost assures that the problem will continue because the manipulators get away with it and thus presented a policy option especially attractive in tough economic times through which they could subsidise their exports, subsidise domestic competition of their imports, thereby subside their jobs without any budget costs domestically or without any effective restraint internationally. It is just too good an alternative to pass up, and many countries have now learned that fundamental fact (Kose, Prasad, Rogoff, & Wie, 2009).

International Currency Cooperation

Why is it that the system has failed so badly even without good enforcement rules in the IMF and WTO, the charters that could have done it? Why could not the big countries get together and do something about it as they have on some other issues in the post-war period? There are two plausible and complementary explanations. One is primarily political, and one is predominantly financial. Charles Kindleberger from the MIT had a straightforward but very persuasive thesis of why the world economy did collapse back in the 1930s and what we had to watch out for now. His thesis was that a world economy could function cooperatively and effectively only under firm enlightened leadership by whatever country or small group of countries that had the economic cloud to lead that system and exercise that cloud in a constructive way. It is inside what happened in the 1930s is that the traditional and previous global leader — the United Kingdom — was no longer able to exercise that leadership. It had lost World War One, and its finances had been designated, its economy was weak. It could not do it anymore. But the rising power — the United States — was unwilling to step into that breach, exercise a leadership role and thereby keep the world together. That explanation, of course, is political economy, not theoretical economics. But it is quite powerful and quite persuasive. The analogy today would, of course, be that the United States has declined in its economic cloud and so can no longer lead the system, but that the rising power — China — is certainly not yet willing or able to do so. Therefore there is a vacuum of leadership. Nobody is to see to it that the rules do get implemented, take matters into own hands to do that if necessary as the US has done in some previous periods. Therefore nobody minds the store, and things devolve and fail. That is a rather persuasive explanation of what happens (Lane & Milesi-Ferretti, 2011).

It is worth a word about why China cannot do it yet because China is the rising power. It will be the world's largest economy within the next five to ten years. It is already a prominent trader. It is by far the biggest surplus country. Three and a half-trillion dollars in reserves — more than three times as much as anybody else — all these ill-gotten to a large extent for the reasons described, but it means that China has become a global economic superpower at this relatively early stage of its development. But it is a unique economic superpower. It remains a relatively poor country — its per capita income is about 10 per cent of the US, even though its entire economy is getting quite close to the US in absolute magnitudes. Its economy has not yet fully marketised or privatised. It retains extensive capital controls, a currency that is not yet convertible. So, it is not a modern economy, however. Its political system, of course, is hardly compatible with those of the traditional economic powers. So, it would be a bit premature, to put it mildly, to expect China to shoulder a kind of global economic leadership that is needed to deal with the problem of this type. Indeed, as is suggested, China is a large part of the problem rather than a leader in resolving it (Pisani-Ferry & Sapir, 2010).

The US side of the equation, though, is worth a short description. The United States is caught in something of a scissors' movement in terms of its role in the world economy. On the one hand, the United States has become increasingly and in some sense critically dependent on the world economy, at least four times as much as in the early 1960s. At that time, the international dimension represented about 10 per cent of the US economy. Today it is 40 per cent. It has quadrupled in fifty years.

On the other hand, the US has become decreasingly able to influence, let alone dominate, the outcome of global economic developments, with half the share of global output it had half a century ago. At that time, the US share of the world economy was 40 per cent, and now it is 20 per cent. So, the US GDP has gone from ten to forty. Its cloud has gone from forty to twenty, ensured the scissors' movement that is crossed, with the US much more dependent and much less able to exercise the kind of leadership it did in the past. That has severely truncated the ability of the United States. Both chores have accelerated over the past decade. From the US standpoint time is not on its side in seeking to promote its global economic interests. But that it is even more fundamental with very saddle reason for both the systemic erosion and its adverse consequences for the United States, and that is the international role of the US dollar. Whether one is talking about fixed exchange rates way back before 1971 or floating rates since there is a fundamental asymmetry in the way the exchange rate system works. The dollar is of course by far the most widely used currency, and therefore there is a world of what can be called in technical terms in currencies, the number of currencies in the world, but only in minus one exchange rates, because one exchange rate has to be the residual of all the others. So, the United States is expected to remain passive in the currency markets, and the exchange rate of the dollar is to a substantial degree determined by the combined actions of other countries including this direct–indirect verbal intervention (Lane & Milesi-Ferretti, 2007).

Global monetary arrangements are based on the implicit grand bargain in which the US accepts the deficits that result from the dollar's role, and that other countries finance those deficits without complaining too much. Conventional wisdom is that the international role of the dollar is very much in the interest of the United States and bad for the world. However, the opposite is true. Other countries benefit from the convenience in cost reduction of a single world currency, and for the manipulators — the ability to set the dollar's price in terms of their currencies. The United States has two very tangible costs. As indicated, other countries can determine the exchange rate between their currencies and the dollar by buying dollars in the foreign exchange markets, and on the monetary side the build-up of dollar balances by other countries comes very directly from the result of intervention meaning that a big flood of money comes into the United States, inflates the money supply, weakens the ability of the monetary policy to cope and therefore can lead to results like the global economic and financial crisis that occurred over the last ten years.

Interestingly, the Chinese recognise the validity of that. The governor of the central bank had a famous speech about ten years ago on the monetary system. And he seemed to be inviting the United States to get out of the business of running an international currency by noting that "when a country's currency is no longer used as the benchmark for other economies, the exchange rate policy of the country would be far more effective in adjusting its economic imbalances". In other words, he was saying, if Americans complain about the Chinese currency manipulation wearing significant surpluses, but that is because the dollar is the currency in which they do it. If the US gets out of that business, the Chinese can no longer do it. The US would be more independent and autonomous. And it would not have the problem. That was a provocative and far-reaching suggestion. It has not been operated on to this point. But it is probably got a lot of truth (Melyantsev, 2015).

The US to be certain benefits to some extent from the international role of the dollar. It makes it easier to finance trade deficits over short periods, which is always very attractive to politicians. The problem is that the international role of the dollar represents the auto-moral hazard for the United States. It is an absence of market pressure on the US to adjust its economic policies, when it should be doing so, like the boom period of the early and middle 2000s, to keep its imbalances both its trade imbalance and its internal budget imbalance which are strictly related to keep those imbalances from reaching unsustainable levels that may require very sharp and very costly correctives as can be seen now (Perskaya & Eskindarov, 2015).

The US budget problem and the US trade deficit are directly related to the failure to act earlier, which was permitted by the build-up of dollar balances by other countries financing the United States. There is some similarity between huge inflows of capital to the United States described and the considerable inflows to southern Europe in the early years of the euro that brought on the euro crises. Both of those big capital flows reflected market judgements driven by keeping essential institutional framework that kept interest rates very low in the capital importing area. What happened in Europe is that once the euro was created, the markets treated Greek debt the same as German debt. The market said these are all members of the Eurozone. There is not going to be any exchange rate movement. These are all part of the same economic union. So, they priced the government paper pretty much the same. And so, the Greeks were able to borrow at the same rates the Germans were able to borrow. It is no surprise therefore that the Greeks went on a huge spending splurge, shopping spree, overspent, over-borrowed their books, lived way beyond their means and finally crashed. And that although the time fuses longer because the US is a much bigger economy with much greater resilience, there are some similarities that the US runs large external deficits, based on large internal deficits. The rest of the world because it "does not have anywhere else to go" tends to finance those for a long time until it decides to stop financing them. And then as happened with Greece, Italy, etc. the interest rate would jump, the shoe will be again pinched, and then all of the US, Canada given its proximity to the United States, will be in big trouble. However, lots of Americans believe that the international role of the dollar is a good thing for the United States. The others call it dollar primacy mentality. There is a wise recognition that at best, the dollar is a mixed blessing for the United States and probably on balance a weak factor and the negative. Until that is overcome, the world will not get a termination of the currency manipulation problem and remedial action (Ostry, 2012).

What is interesting is that the Congress of the United States seems to understand this. The Congress of the United States is typically thought of as being pretty chauvinistic and pretty nationalistic and pretty narrow-minded and even xenophobic and isolationist. It is just throughout a few adjectives that generally describe the Congress. But in this case the Congress seems to have recognised that this dollar primacy mentality is rampant on Wall Street, and some parts of US business community is a huge mistake in terms of the strength of the US economy, the creation of jobs, the maintenance of external and internal balance and the sustainability of the American economy. It is fascinating when Congress gets it, and the Administration does not. The US Administration has been short-sighted on this issue, and finally, Congress is beginning to force them to act.

The Policies that Should Be Adopted to Deal with the International Currency Conflict

So, what's to be done? Systemic reform is required. It needs to include both changes in the rules and particularly much stricter enforcement of those rules. The governance structures through which the rules are implemented must, of course also be substantially revised to legitimise a new regime and to promote both its initial acceptability and thus its sustainability. These systemic changes deal with the substantial systemic problem which needs to occur both through the International Monetary Fund and the World Trade Organisation. It is a problem that cuts across monetary issues and trade issues — both need to be deployed in response. Both these institutions have rules against competitive currency undervaluation. The IMF rule is clear, but it has no enforcement mechanism. The World Trade Organisation does have an enforcement mechanism, but its provision is much more ambiguous, and it has never been attempted and probably would not work if it did. The United States has been trying for a decade to persuade China to let its currency go much faster by significant amounts, but its success has been very modest, importantly due to the absence of effective international rules and procedures that it could mobilise for that purpose. In the case of the IMF the chief need is to add effective policy instruments to enforce the two existing rules. The prescription of significantly undervalued exchange rates that are maintained by protracted large-scale intervention in one direction and a failure by violators to consult with the country in whose currency they plan to intervene. The IMF rules should thus be reinforced to provide for the first time effective sanctions against countries that wanted to protest.

First, the maintenance of a significantly undervalued exchange rate.

Second, through extensive intervention in the currency markets described.

What can be proposed is that a new sanction is brought into the toolbox. It is what can be called countervailing currency intervention. If Japan — to take one of the most recent local cases — buys a billion dollars to keep the dollar overvalued and the yen undervalued, why should not the United States do the reverse? By a billion dollars of yen to push the yen back up and the dollar back down and to offset, counteract, countervail the effect of what the Japanese have done. That would be meeting the punishment, or matching the punishment to the crime. It would not be a huge cataclysmic on global financial markets. And if the United States did it two or three times, it would successfully deter other countries from carrying out the practice because then they would know they will have no benefit, and everybody would wind up where they started. A measure of that type — and it is deliberately called countervailing currency intervention — would parallel a very wide-spread trade policy rule under which countries can apply countervailing import duties and tariffs against export subsidies that are prohibited.

This currency manipulation is the same as an export subsidy. It keeps the price of exports low and therefore a similar response in kind, but this time through the currency markets, which seems to make perfect sense should be done and would be a directly applicable remedy. If the country that was being intervened against felt that it was unjustly treated, it could protest to the International Monetary Fund. If it was found to be right, and the countervailing was found to be wrong, the IMF could tell them to cease, and they will have to do so. That is why it is crucial to embed the new rules in the international system so that nobody will try to bully anybody else in the process.

A second new policy instrument would be to tax the build-up of foreign currency reserves that are the results of the intervention. As was said before, when China buys dollars to keep its currency weak, it has to invest those dollars somewhere back in the United States, and it gets interested in those. The US could tax those, or it could even stop paying interest, or it can even prohibit their increasing holding amounts of dollars from making clear that it wanted no part of their currency manipulation. That too would be a perfectly logical response, and for technical reasons one might need to do that with countries that have inconvertible currencies like China. So, those would be the new instruments on the monetary side.

Two changes could also be made on the trade policy side. Some would immediately say that is protectionism. But what the US is responding to here is protectionism. It is anti-protectionism because when countries manipulate their currencies, keep them undervalued when they have trade surpluses, it is the equivalent of big export subsidies or big import barriers. The Chinese currency intervention over the last decade is the most prominent protectionist policy in the history of humankind. It is much more significant than the smooth early tariff that the United States put on in the 1930s or any other trade policy device that one could ever find in the history of the world economy.

So, if one wants to deter it and/or respond to it to protect economic interests in the short run, the two things one could do on the trade side. One would be to add manipulated currency intervention described to the list of prohibited export subsidies against which countervailing import duties could be levied. Currency manipulation is just like any other export subsidy in terms of driving down the price of the exported product. That is legitimate under the trading rules that still exist today to put on a countervailing tariff against those. The only issue is whether the currency intervention counts as an export subsidy. That is a hotly debated topic. It has not been defined as such by most countries, although Brazil has begun to do so. The United States, Canada and others should do so. Again, the deterring effect on the countries that manipulate would be quite significant.

A second and even more significant trade action would be to invoke an existing rule on the WTO. There is a rule that says any country that frustrates the intent of the agreement, the trade agreement through currency manipulation, justifies the erection of across-the-board import barriers against it, and across-the-import surcharge or some equivalent measure that reacted across the board not just case by case as with the countervailing duties to a country that was manipulating its currency for trade reasons, but again it would have major deterred effect. One could make those changes either through amending the charters of the IMF with the WTO — or by more likely just developing a consensus on the issue and doing it through a coalition of the willing mentioned before — a subgroup that was willing to move ahead in that way if one could not get a wide-spread agreement.

Another tactic is to build rules of this type, including sanctions into new trade agreements. And this, of course, can directly relevant to Canada because Canada is a participant in the Transpacific Partnership negotiation that is trying to forge modern trade rules, open markets, expand trade and investment among all the major countries of the Pacific Rim. If it succeeds, it will be the biggest trade deal in history next to the European Union. And it will be a major game-changer in terms of Transpacific security, political as well as economic relations. That is the agreement that the Congress is now saying they will only approve if it addresses this currency issue. So what can be suggested is that as developed countries, including the US and Canada negotiate this new trade agreement that they add one more chapter. There are twenty-nine chapters in the agreement now. It is a very complex and far-reaching trade agreement which is its virtue, although it is difficult, congressmen are saying — add one more crucial chapter that would address this currency issue. And the chapter, though nobody has worked out the details of it yet, would repeat the prohibitions on currency manipulation as in the IMF now would subject the issue to the dispute settlement mechanism of the whole trade agreement. In other words, if one participant, say, Australia, feels it is adversely affected by another participant, Mexico, Australia can take Mexico to the dispute settlement agreement, and say, it is violating the prescription on currency manipulation. If the multilateral dispute settlement mechanism says Australia is right, then Mexico will have to cease, or Australia is authorised to withdraw all the trade concessions it gave Mexico in the agreement. That is called in the trade policy jargon 'a snapback' of the trade liberalisation that had been implemented, and nobody wants to de-liberalise trade. But if there is no effective deterrent in practice, then the practice continues. So, the idea would be to start using new trade agreements. The Congress says not just that they pass partnership, but all future US trade agreements should have effective mechanisms to deal with this currency problem or else the Congress is not going to implement that.

Obviously, it would be better if one could negotiate these reforms internationally and multilaterally. But as is known from the last decade of trying to get international agreement on this issue that it is not very likely one could do so. There is a potential pretty wide-spread coalition of countries that are adversely affected — the United States, the Eurozone, some emerging markets like Mexico, Brazil, India have been very vocally critical of China and the other manipulators. So, there are several candidates for a coalition of that type which then could begin to put those new international concords into practice and start to deal with the problem. Hopefully, once that happened, one could then formalise the multilateralisation of the rules, put it into the institutions and make it a new feature of the system.

As is indicated the fathers of the post-war monetary system, way back at Bretton Woods, tried to prescribe these practices to avoid a replication of what happened in the 1930s. They failed to do so. Now would be the time to complete that process seventy years later.

The conclusion is that such systemic reforms and/or plurilateral actions along the way to terminate the contemporary currency wars would have a substantial payoff for the countries that are adversely affected by the current competitive depreciations. The US, for its part, could see a straight deficit cut by several hundred billion dollars per year. And its unemployment rolls drop by at least a couple of million. The Eurozone would be the second-largest beneficiary to the tune of a hundred billion dollars or so and a considerable number of jobs. And if the issue could be put to rest in these relatively constructive ways, the threat of protectionist trade policies and hard landings in deficit countries with overvalued currencies should recede substantially.

For the longer run, the benefit of all this is that the greatest flaw in the global economic order of the past seventy years would be overcome. The system would become much stronger in response to large imbalances and to head them off by deterring predatory currencies. These institutional pillars of the world economy, the International Monetary Fund, the World Trade Organisation would become far more effective and far more credible.

The US addressed another vital issue of US interests in which China also plays an essential role back in the State of the Union Message — cyber-security. And it is said that one cannot look back years from now and wonder why they did nothing. When there is a breach of enormous importance, and the international community is frozen and does not act, then the norm begins to unravel. One should adopt the same attitude to a wide-spread currency manipulation which violates the most basic precepts of the international economic system or destroying growth and jobs in diverse economies.

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Международные конфликты в современной мировой валютной системе

Михаил Вячеславович Жариков

доктор экономических наук, профессор, Департамент мировой экономики и мировых финансов, Финансовый университет, Москва, Россия; главный научный сотрудник, Институт мировой экономики и международных финансов, Финансовый университет, Москва, Россия

Аннотация. В статье рассмотрены вопросы, связанные с так называемым феноменом международного валютного конфликта. Исследование позволило выявить его влияние на экономику различных стран мира, включая США, Канаду, слабые периферийные страны зоны евро и ряда других государств, которые не прибегают к использованию инструментов интервенции на валютный рынок. Выявлено, что эти тенденции и отрицательные внешние эффекты глобальных валютных спекуляций проистекают из системных проблем международной финансовой архитектуры. Теоретическая значимость результатов исследования заключается в том, что фундаментальная проблема глобального режима валютных курсов охватывает одновременно и валютную, и внешнеторговую системы, а также указывает на дефицит международного сотрудничества для решения валютных проблем. Практическая значимость результатов работы состоит в том, что в них изложены подходы к принятию системных реформ для воспрепятствования целенаправленной валютной политики отдельных стран сегодня и в будущем. Сделан вывод о том, что в настоящее время складываются предпосылки для международных действий по выработке конструктивных решений международной системной валютной проблемы.

Ключевые слова: международная валютная система; валютные войны; международный валютный конфликт; валютная интервенция; оборонительная валютная интервенция; противодействующие импортные пошлины; конкурентная валютная интервенция

Статья подготовлена по результатам исследований, выполненных за счет бюджетных средств по государственному заданию Финуниверситету.