
Development of the International Monetary System Conditions of Globalization

I.N. Efremenko¹, L. Haabazoka², V.A. Larionov³

Corresponding author: *I.N. Efremenko, Rostov State University of Economics, 69, Bolshaya Sadovaya str., Rostov-on-Don, 344002, Russian Federation. Tel. +7863-261-3814. E-mail: efremenko@yandex.ru*

Abstract:

This paper outlines the modern trends in the development of the international monetary system in conditions of financial globalization.

The paper establishes that the international monetary system has evolved through different stages necessitated by various economic crises at different periodic intervals. It is noted in the paper that despite the inefficiencies in the current dollar denominated international monetary system developed countries are reluctant to do any reforms.

However, International monetary system reform is obvious and most likely will happen under the growing crisis in the international financial systems and credit relations. It is proposed that countries look at new innovations that will make international transactions cheaper and less risky.

Keywords

Globalization, world financial system, international currency credit relations, international monetary system.

JEL Classification Codes: *F60, F63, O35, O44*

¹ *Efremenko Innessa Nikolaevna, ph.d., associate professor, Department of Financial Monitoring and Financial markets, Rostov State University of Economics, Rostov-on-Don, Russian Federation.*

² *Haabazoka Lubinda, ph.d., Senior Lecturer, School of Business, Copperbelt University, Kitwe, Zambia.*

³ *Larionov Vladimir Alexandrovich, ph.d., Deputy general manager quality assurance Swissotel Resort, Sochi, Russian Federation.*

1. Introduction

The international monetary system remains one of the most important supporting factors of international trade. A stable international monetary system ensures that there is an effective international movement of capital, stable exchange rates and efficient international payment systems. Uncertainty and the current geopolitical developments in the world coupled with slow economic growth have however, led to increased risks in the international monetary system. The fall of commodity prices around the world has also led to instability in the international monetary system with developing countries affected the most. The decrease in China's economic growth caused by a reduction in the demand for Chinese goods has also negatively affected the international monetary system. All these factors have led to tougher financial conditions and a decline in global financial stability leading to calls for the introduction of a new international monetary system (Boldeanu and Tache, 2016; Vovchenko *et al.*, 2017a; 2017b).

The evolution of the international monetary system has been a process in which successes and failures of previous stages have prompted and been incorporated into the next stage (Jane D'Arista, 2009). D'Arista notes that the success of the evolving gold exchange standard in the early 1900s led to its adoption in the 1920s as stagnation in gold production created the need for an expansion of reserves to promote growth. She further notes that the collapse of foreign exchange reserves in the period 1928–32 led the two major participants in the Bretton Woods discussions to emphasize the need for a system that would promote liquidity. D'Arista notes that most of the 60 years since the dollar assumed the role of key currency; the system has not impeded the ability of central banks in countries with well developed financial markets to maintain liquidity and promote growth. But countries without developed financial markets have experienced monetary jolts similar to those they suffered under the gold standard and through World War II.

It is also noted that there is a possibility that a monetary collapse could engulf the entire global economy—that a loss in the value of the key currency could precipitate a world-wide shrinkage in credit that would deepen the financial and economic crisis already underway. The successful economic performance of the USA that was the real backing for the dollar has eroded at the same time that growing US dependence on foreign savings for that performance has increased its vulnerability. D'Arista further establishes that the current focus on stimulus programmes and financial regulation suggests that the G20 may attempt to solve the crisis without addressing the monetary aspect that is exacerbating the problem. If so, one must hope that other governmental and non-governmental groups will exert pressure to take up the discussion at a level that can realize the needed reforms. This paper seeks to establish the modern trends in the development of the international monetary system in conditions of financial globalization. The paper also seeks to offer recommendations on how best reforms could be made in the international monetary markets.

2. Theoretical and methodological framework of the study

There have been significant changes to the existing approaches in international monetary system reforms. All these changes have had a great impact on the formation process and financial architecture transformation leading to a number of new trends in international monetary system evolution process. Many scholars have noted the high importance of such concepts as transparency, reliability of provided information, financial markets liquidity and the "infection" effect.

In their work "The Reconstruction of the International Financial Architecture: Keynes' Revenge?", André Cartapanis and Michel Herland Centre from the University of Mediterranean Aix-Marseille argue that in changes to the existing approaches in international monetary system reforms one can see Keynes' revenge. Keynes stood for more stringent rules governing the international markets at the Bretton Woods Conference.

With the current obtaining trends in international monetary system developments, one can suggest that some of Keynes's provisions are becoming relevant under the current unfavorable geopolitical climate. André Cartapanis and Michel Herland Centre also explain in detail the inevitable problems and risks that come with establishing a currency system based on regulated exchange rates. They also considered the differences in interests of different countries in monetary policy issues as the main obstacle for the international cooperation in the area of international monetary system reforms. André Cartapanis and Michel Herland Centre also foresaw the negative results of linking currencies of countries with weaker economies to currencies of countries with strong economies since such measures make it difficult for weaker countries to conduct independent monetary policies.

It is necessary to note that in Keynes' works, two approaches to stimulate demand were suggested: interest rates reduction and budget police promotion that combines tax benefits and subsidies to increase income for the poor. According to Keynes, the result of this intervention will be production and employment growth, eventually resulting in demand growth. However, the negative consequence of these measures is the activation of inflation processes which Keynes proposes to control.

With this approach, there is a certain departure from pure market regulation of the economy, and through public investments, monetary and credit policy, the elements of the planned type of world and national economies appear, since under the increasing global geopolitical cataclysm the self-regulation ability decreases.

"Keynes theory of aggregate demand brings a qualitatively new direction in economic system development. It is with Keynes' theory that a national economy turns into and integrated system which is can be called a macro economy unlike a micro economy. In the frames of this theory the economic mechanism to curb the

market element with state regulation of the whole macroeconomics was formed. On the basis of this theory, long-term tendency to strengthen the state impact on the macroeconomic equilibrium was formed and continues its development”.

According to experts from the International Monetary Fund, the potential growth of national economies with the emerging markets will gradually reduce from 6.5% in the period from 2008-2014 up to 5.2 % in the period from 2015-2020. The main reasons for this reduction include the presence of structural constraints affecting the growth of investment, productivity growth slowdown due to the exhaustion of the potential of innovative technologies application and the aging of the population.

It is also noted that the 2008 financial crisis was necessitated by the population’s purchasing power reduction that resulted in low demand for loans from enterprises around the developing world. This also resulted in general reduction of liquidity and caused recession in the US economy. Because of this, the US government carried out a policy of quantitative easing in order to prevent a decline in business activity. M. Khazin (2009) notes that the strategy of demand stimulation consists of two things: Household debt growth and interest rate reduction. To understand Khazin’s strategy, we look at the following: Since the beginning of the 2008 crisis about 4 trillion dollars were put into circulation to support national economies. Partially this served to redeem the commercial securities from banks (including mortgage), as well as government bonds. It was assumed that the received liquidity will be used by banks to lend to businesses and the population. Refinancing rate reduction was also used to stimulate demand for loans. By the end of 2008 the average annual US interest rate was reduced to 0.25% and remained stable for the following years”.

Specialists in international relations have argued that international regimes operate smoothly and exhibit stability only when dominated by a single, exceptionally powerful national economy (Eichengreen, 1987; Allegret *et al.*, 2016; Thalassinos *et al.*, 2015; Rupeika-Apoga and Nedovis, 2015; Pociovalisteanu and Thalassinos, 2008). In particular, this "theory of hegemonic stability" has been applied to the international monetary system. Eichengreen notes that the maintenance of the Bretton Woods System for a quarter century through 1971 is ascribed to the singular power of the United States in the postwar world, while the persistence of the classical gold standard is similarly ascribed to Britain's dominance of the 19th-century international economy. In contrast, the instability of the interwar gold exchange standard is attributed to the absence of a hegemonic power. Eichengreen concludes that while the theory of hegemonic stability is of some help for understanding the relatively smooth operation of the classical gold standard and early Bretton Woods System as well as some of the difficulties of the interwar years, much of the evidence proves to be difficult to reconcile with the hegemonic stability view.

3. Discussions and Results

The formation and subsequent evolution of the international monetary system reflects the development of capital internationalization processes, requiring adequate conditions in the international monetary sphere. The international monetary and financial system development is historically preconditioned. The monetary policy of any country is based on theoretical models of the scientists belonging to different economic schools. The representatives of different trends in economics propose different methods of monetary system regulation. Each new concept expresses the position of a certain social group and a certain period of time. Some theories remain topical for a long period of time. The transformation of the world economy is also supported by new ideas from newly developed currency theories.

In the recent past, all efforts by national financial regulators did not manage to stabilize exchange rates of their currencies when it became evident that the Euro and the US dollar started significantly depreciating against their currencies. The failure of individual country monetary policies revealed a deliberate US dollar and euro devaluation, implemented in the USA and Europe to maintain the stability of the US and EU economies. Developed nations without consulting developing nations pursued a monetary policy that weakened their currencies.

The Central Bank of England used a similar strategy having reduced interest rates in 2010 to 0.5% and preserving them at the same level for some time. This led to the possibility of pound sterling devaluation against the US dollar and euro in 2010. However, this trend was not kept and in the period 2011-2012 the currency strengthened against the EUR / USD currency pair. In the period 2015-2016 the British currency continued to decline against the US dollar and the euro, as Figure 1 shows.

In Switzerland however, the application of softening rates strategy to stimulate demand was not possible because interest rates were initially low. If this strategy was used, inflation was going to rise due to a further increase in money supply. We therefore observe the exhaustion of the potential of the stimulating demand strategy application through a controlled evaluation of national currencies and lowering interest rates.

It should be mentioned that currently, there is no clear and reasoned vision of the future long-term strategy in the world financial system development. It is preconditioned by complexity of the geopolitical situation, active changes and application of innovative technologies, the possibility for the multi polar world order development.

Undoubtedly, changes in the world financial system occur under the influence of the objective processes i.e. changes in the international labor, the international trade growth, redistribution of geopolitical influence centers, etc.

The change in the structure of the International monetary system occurs as per rule

in periods of global economic crisis. The current state of the world economy against the background of rapidly developing negative processes in geopolitics can be called a crisis. However, there are no specific measures that have been taken by countries to modernize the current global monetary system.

The phenomenon of dollarization is a graphic example of the significant role of the dollar as the world reserve currency over the past decades. The dollarization of an economy is a phenomenon of the international money market, in which foreign currency (most often it is the US dollar) is widely used for operations inside the country or individual sectors of its economy, up to the complete replacement of the national currency as can be observed in countries like Zimbabwe.

Scholars recognize the ambiguous impact of dollarization on economic and finance systems of the countries where it is spread. International Monetary Fund economists did a research concerning the reasons of dollarization and considered the effectiveness of possible actions by national financial regulators aimed at dollarization restriction and minimizing the risks of dollarization. Scholars mention the necessity of complex reforms which should be implemented to ensure there are minimal dollarization risks in favor of the domestic currency. Qualitative limitations can also be used to accelerate the reduction of dollarization. However, the risks of such limitations can be very high. Decrease in world market demand for the US dollars that emerged in the recent past was due to economic growth of the developing countries and also the reduction in business activity of US banks. This led to a growing gap between demand for dollars and their supply. The emerging surplus of the dollar mass, given the credit nature of this currency and its actual insecurity, made the possibility of the dollar to fulfill the functions of an international reserve currency for the next stage of the financial architecture development doubtful.

However, according to existing literature, it is quite obvious that the US dollar continues to influence equity markets and commodity prices for the last decades. Gold prices also seem to be in close positive correlation with the US dollar.

The USA National Bureau of Economic Research economists conducted a research on the macroeconomic consequences of US dollar domination of the international monetary fund. Their study was based on a two-country model, in which export is calculated in the key currency, and government bonds nominated in the key currency are issued on the international market. Domestic government bonds and money are used in each country for internal transactions. The model reproduces the deviations from uncovered percentage parity, corresponding to empirical estimates. Other empirical anomalies are also investigated in the model, for example, the Backus-Smith paradox. The essence of the paradox is as follows: The effective risk sharing theoretically means positive relationship between actual exchange rates and relative consumption. Consumption is relatively higher where it is cheaper. However, the correlation calculation based on practical data between actual exchange rates and

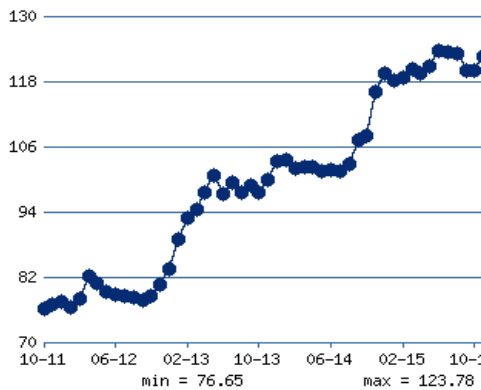
relative consumption shows a negative relationship.

The researchers come to a conclusion that the shocks in countries whose currency is key (reserve) have greater impact on world economy destabilization, than shocks occurring in smaller countries. And the innovations in the monetary and fiscal policy in the country, whose currency is a key one, are more effective than the similar ones in other countries. On the other hand, the country whose currency is a key one is more vulnerable to the financial market turbulence. Thus, it is possible to conclude that in the middle-run, the US dollar most probably will preserve its domination and its influence on the world price system, and consequently, on the financial systems of commodity export oriented countries like Russia.

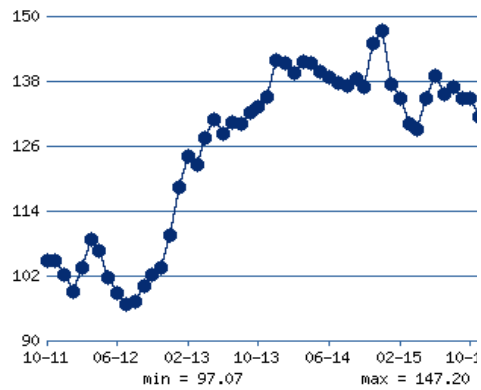
It is necessary to distinguish some of the most discussable trends of the world currency system reforms. This is, first of all, the application of collective currencies created in the process of economic integration as an alternative to the multi polar development of the world financial system. The extension of list of the reserve currencies is often considered as an alternative of the modern world currency system development. Such an alternative of the international monetary system development will result in the growing of a number of currencies competing with dollar and consequently, will lead to the reduction of dollar dependency in the global economy and on the geopolitical domination of the US economy as well as the risk of crisis phenomena spreading from the economy issuing the dominating world currency. However, currently the US dollar has preserved position as the main currency of the international monetary system.

Despite the fact that The IMF included the Chinese Yuan in the list of the reserve currencies in 2016, the problem of the extension of the list of key currencies is still relevant. One factor that led to China being the second largest economy in the world was exports to the USA. To achieve this status, Chinese authorities took active steps of increasing the international significance of Yuan. In 2010, the pegging of the national Chinese currency to the US dollar was abandoned, making the Yuan a currency with flexible exchange rates. The importance of the Yuan in international transactions however remains insignificant.

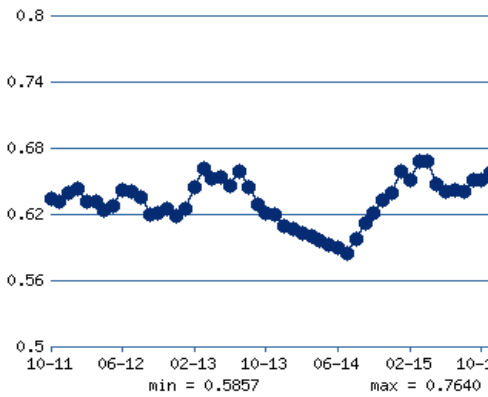
At the same time, the strive of national financial regulators through monetary policy tools to stimulate demand and maintain convenient exchange rates for individual countries in a dollar denominated financial system has failed to yield desired results. Linkevich (2010) suggests an innovative approach of international monetary system development based on the polyinstrumental standard application. This approach allows the preserve of the sovereignty of national economies in monetary policy regulation to protect currency stability from the negative consequences of global processes. However, there is no practical implementation due to the complexity to comprehend the proposed idea and the deterring geopolitical factors.



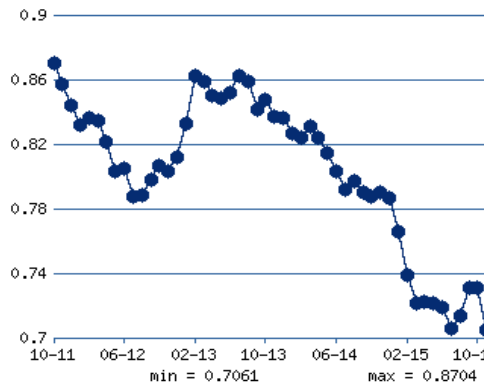
Yen to dollar exchange rate



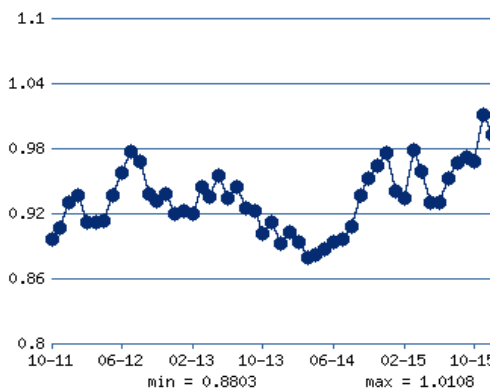
Yen to euro exchange rate



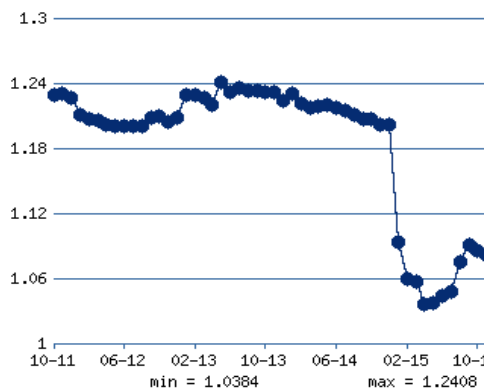
Pound to dollar exchange rate



Yen to euro exchange rate



Franc to dollar exchange rate



Franc to Euro exchange rate

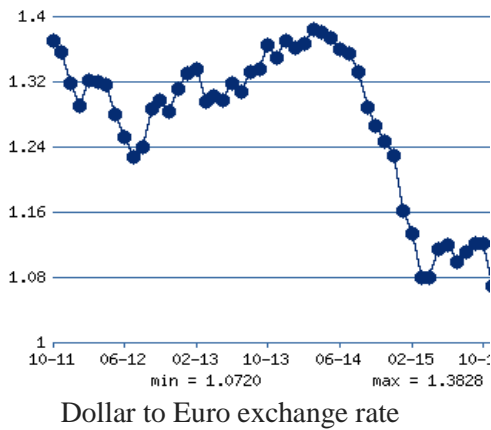


Figure 1. Rates of leading currency pairs for the period from October 2011 to June 2016

Source. <http://www.ereport.ru/stat.php?razdel=currency&table=chfusd&time=2>, Date of the address 26.10.2016

Some researchers analyze variants to return to the gold standard or its evolution up to the multi-commodity standard. The problem of this theory is the lack of a common international goods standardization system. Other scholars call for the use of one currency or even the use of the IMF Special Drawing Rights (SDR) as currency.

4. Conclusions and recommendations

All mentioned above variants of possible international currencies will remain unresolved in the short-run because of the reluctance of the USA and other leading countries to change the existing international financial infrastructure. Ultimately, with the development of new information systems, new e-payment solutions that work with minimum costs and risk, the need for national currencies will quickly reduce. One such innovation, which allows the limitation of the use of national currencies is the blockchain technology known mainly as a technology that works with the Bitcoin cryptocurrency.

In the analytical paper "BLOCKCHAIN in the capital markets", Gadzhen and Shapochkin note, that the technology of blockchain (or distributed databases) implies a new management approach of information exchange and data. This technological application creates conditions where all market participants work simultaneously in a single data base. This approach creates a transparent environment to use actual data and online calculations. Currently, companies use this technology while working with cryptocurrencies and such tools as "online wallets". However technology application prospects for Blockchain remain much wider. This technology can be effectively introduced while performing a whole

range of the financial operations, namely related to international payments. The following conditions should prevail in order for countries to use the blockchain technology:

- To ground technology application feasibility for a wide range of users, transition from innovative to widely used technology due to the fact, that leading actors on the international system payments take a decision to apply it;
- It is necessary to generate demand among the payments participants and the institutional conditions to be created by the leading participants in international settlements for the users to apply the technology;
- To ground potential benefits from the operation costs reduction (this problem is to be solved by the technology designers);
- Permanent modernization and creation of an initial scenario of the updating possibility to adapt the innovation and to eliminate the shortcomings identified in the initial stages of implementation;
- Availability of technical experts having proper skills to develop and maintain operations;
- Regulatory support for the introduction of this technology.

At the same time the question of crypto currencies application and impact of this process on the level of the national financial security has not been researched enough. In 2014 FATF in its report “Key definitions and potential risks in the area of AML / CFT”» described in detail the possible risks of using crypto currency such as increase in money laundry and financial crime.

The Russian central bank continues to express its concerns over the rise in crypto currency use. Russian legislation does not forbid the application of blockchain in contrast to crypto currencies. The main application problems seem to come from the storage of data on banking operations because there is not a unified place to store this information. The identified above conditions allow concluding that it is necessary to form a super national working group to develop this process. This group should comprise both the representatives of the leading financial institutions, big technological companies and of course representatives of various national financial regulators.

Summing up the results of the conducted research, we can conclude that at the moment there is no established trend in the world currency system development. However, its reform is obvious and most likely will happen under the growing crisis in the international financial systems and credit relations.

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