The Future of the Global Monetary System

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Abstract. The article is devoted to the reasons of global financial instability and the forecast of the development of the world monetary system. The roles and prospects of the United States, the European Union and BRICS countries are considered. Analyzed the role and place of gold in the present and future. A review and evaluation of cryptocurrency as an alternative to traditional money is given. At the end of the article, the most likely scenarios for the transformation of the world monetary system are presented.

1. Genesis and Development of the Existing World Monetary System

The modern world monetary system is, on the one hand, the product of the natural development of the world economy over the past 75 years, on the other hand, the product of the conscious construction of the hegemony of the US dollar.

During the Second World War, the United States not only did not actually suffer from the war, but also strengthened its economic power. And besides, the USA both was and remains practically the only economy producing all or almost all, and at the same time it is the largest market that buys all or almost all types of goods and services produced in the world. In other words, you can pay with dollars everything that is produced in America and sell to America for dollars everything that America buy.

The actual financial factors that ensured the rise of the dollar to its current role were lending to foreign countries in dollars and supporting the dollar on the world's largest gold reserves in 1944-1971. To repay a loan in dollars - you need to buy dollars. To buy dollars - you need to sell gold.

The United States abandoned the mechanism of the exchange of dollars for gold, dangerous for the volume of their gold reserve, in August 1971. This circumstance was a key factor in the breakup of the Bretton Woods monetary system.

Legally, the demonetization of gold on a global scale was framed in Article VI of the IMF Charter in 1978. At this point, the US dollar actually replaced gold, becoming a measure of the value of any goods and services in the world economy and a key component of international reserves.

In parallel, the role of the issuer of the dollar has changed - the United States ceased to be the largest lender in the world and began to turn into the largest borrower. This allowed (and now allows) to cover the chronic trade balance deficit by issuing debt in its national currency.

However, gradually this mechanism begins to collapse. The economic role of the United States is declining - from 1960 to 2018, their contribution to global GDP decreased from 40% to about 23.5%.

This is reflected in the structure of the SDR. If at the time of its appearance, 01/01/1970, 1 SDR was equal to 1 US dollar, now SDR is a basket of currencies (see Fig. 1) [1].

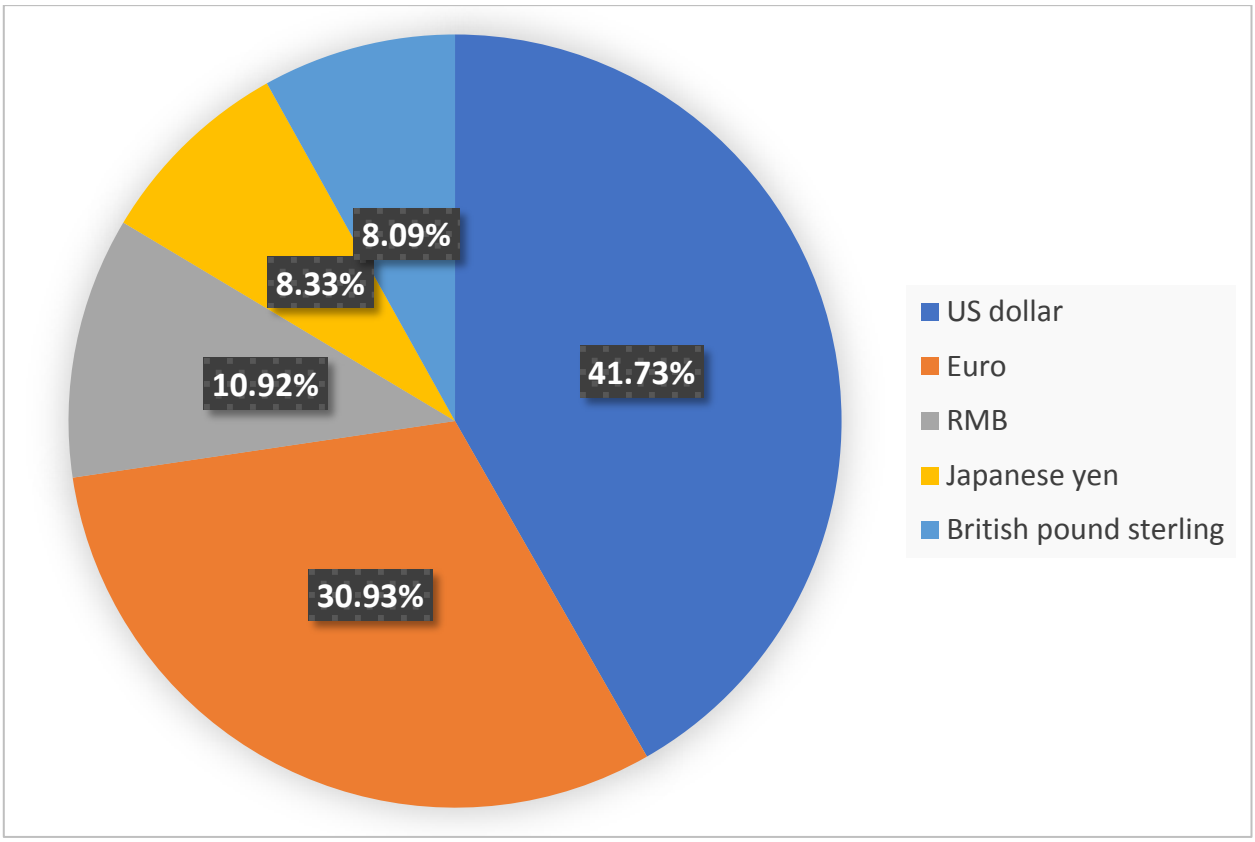

Figure 1. Current SDR basket of currencies

Nevertheless, the US dollar still holds a key position in the global financial system. This provision is reflected in the Table № 1 [2].

Table 1. US Dollar role in the world monetary system

Financial sector	US Dollar Share
Foreign exchange transactions	88 %
Global foreign exchange reserves	63 %
Invoicing of import of countries other than USA	40 %
International debt securities issuance	62 %
All debt securities issuance	49 %
All cross-border claims of the banks	48 %

That is, if the issuer of debt securities is not an American state, it often issues them in US dollars than in any other currency. If the bank - the creditor - is not an American bank, it most often issues loans in US dollars than in any other currency. If neither the exporter nor the importer is a US company, they often prefer to pay in US dollars than in any other currency.

2. Looking for Alternative

Will this system remain forever? Of course not. As the ancient Romans used to say *Nihil dat fortuna mancipio*.

We all know very well that before World War I, the British pound sterling played a role very similar to the current role of the US dollar. By the way, it was Great Britain who introduced the gold standard and imposed it on the rest of the world. The First World War changed the balance of

power - the “workshop of the world” was forced to cede its place on the economic Olympus to the USA. Even the introduction of protectionist measures restricting the access of American goods to the vast market of the British Empire did not help the pound to retain its previous role.

Currently, there are several factors contributing to the decline in the role of the US dollar. And the value of these factors is constantly increasing.

This is, firstly, a gradual but steady decline in the US contribution to the global economy, described in the previous section of this article.

Secondly, the huge public debt of the United States, exceeding 22 trillion US dollars [3]. Even considering that approximately 25% of this debt is accounted for by intragovernmental holdings, this is a huge amount. Obviously, a stronger push than in 2008 could bring down this pyramid.

Third, a combination of factors of global instability: growing imbalances in the global economy, trade wars, volatility of financial markets, political and social tensions in many regions of the world, local wars. The US economy, of course, is influenced by all these factors.

Fourth, the development of new centers of economic and political power, seeking autonomy and independence.

And finally, the fifth. The US itself is helping to weaken the hegemony of the dollar, using its exclusive position to restrict the activities of countries that are not acceptable to them, to punish some regimes, individual banks or companies.

It annoys many countries. Of course, statements about the possible abandonment of the dollar by countries such as Venezuela, Iran or Turkey do not violate the established order - the economic and political weight of these countries on a global scale is incomparable with the United States.

But the initiatives of the European Union, China and Russia may have a more significant impact on the global financial system.

In early December of 2018, the European Commission published a program aimed at enhancing the role of the euro in world finances. It is planned to increase the share of the euro in international payments, primarily for energy [4] and products of strategic industries and expanding the range of financial instruments in euros.

The reasons for developing such a strategy in the European Union are more than serious. For example, the European Union is the largest importer of energy in the world. The average annual cost of energy they consume is 300 billion euros. And 85% of this amount is paid in US dollars, while only 2% of energy comes from the US [4].

China, whose currency is now a reserve, is actively promoting it to international financial markets. Currently, approximately 25% of China's trade is paid by RMB. RMB has become the second most commonly used currency in trade finance.

Russia, which is one of the largest exporters of energy resources, is also moving in the direction of reducing the use of the dollar both in settlements and reserves.

Of course, this does not fundamentally change the situation in world finances. For example, the euro, the second most used reserve currency, is only 21% in international reserves, i.e. almost 3 times less than a dollar.

But the desire to at least reduce use of dollar is a trend and it is worth paying attention to it.

How big are the chances that one of the currencies of large countries or regional alliances will force out the dollar?

At first glance, euro has the best chances. This is the second most important currency of international reserves and international settlements. The European Union has a powerful economy that produces, like the American, everything or almost everything.

But there is a significant difference. The USA is a state, the European Union is an alliance of states.

Moreover, from an economic point of view, the European Union is an unequal alliance between donor countries and recipient countries. Unequal because the recipients live at the donors’ expenses. I do not want to say that recipients receiving financial assistance from the EU’s general budget would not be able to live without it at all. Probably could, but much worse than now. This thesis is easy to illustrate with a list of net donors, which includes only 10 countries out of 28 EU members:

Austria, Belgium, Denmark, Germany, Great Britain, Finland, France, Italy, the Netherlands, Sweden.

Besides, the UK plans to withdraw from the European Union. Even if she reconsiders this decision, the cracks in the European Union building have already gone.

The discussion of Brexit unequivocally showed that EU donors are not eager to continue the policy of cohesion and insist on its correction [5]. If the policy of cohesion continues, then the prospects for the European economy and the euro are rather bad. The European economy is the economy of Western Europe, supplemented by Northern Europe. All the rest is a ballast that reduces productivity and profitability and increases the cost of production. If the policy of cohesion is curtailed, then the fate of the euro has two options, depending on the degree of disintegration of the EU.

A hard option means a return to the national currencies that applied before the euro was introduced. I think that currencies of countries with a strong economy have a high return potential, but its implementation will take time. The soft option assumes that the euro will play the role of a common currency of the EU core countries (Austria, Belgium, Germany, Italy, France, the Netherlands) and, possibly, Spain and Portugal, which are closely integrated with the “old” EU. In this case, the euro, having inevitably lost some of its attractiveness in the short term, in the medium and long term, will not only return its positions, but, most likely, will strengthen them.

But this, however, will not help the euro take the place of the dollar. Since the European Union will remain an alliance of states whose positions on all issues must be harmonized and reconciled, but not the state that pursue a common policy, including financial policy. That is why investors prefer dollar when volatility of financial markets is increasing.

The history of both the US dollar and the British pound shows that the issuer of a currency that has a monopoly position can only be a country with both great economic, military and political power and global interests.

That is why, for example, the Swiss franc, which is the most reliable currency in the last 200 years, more reliable than both the US dollar and the British pound sterling, has never occupied a similar position in the global financial system.

In this case, the chances of RMB look more attractive. And China has done a lot to strengthen its currency.

First, this is the general level of the Chinese economy, which experts of both the IMF and the World Bank put in terms of GDP in first place in the world [1, 6].

The second is the inclusion of RMB in the SDR currencies basket.

Thirdly, it is an active policy of the People’s Bank of China, promoting the RMB as the currency of international payments. Now in the field of trade finance, it is the second most popular currency in the world, accounting for 25% in this area.

Fourthly, this is the successful integration of Hong Kong, one of the largest financial centers in the world. Of course, this contributes to the strengthening of China’s financial system.

But at the same time, China is significantly inferior to the United States in the scientific and technical potential of its economy and in the field of high-tech products.

The currencies of such large and influential countries as Brazil, India, Russia has even less chances to take the place of US dollar.

Brazil has a huge potential for development, but in terms of scientific and technical potential, it is inferior to the United States even more than China. In addition, this country has many social problems that it needs to solve. Besides, Brazil’s interests are regional and focused on the Latin American continent. And finally, this country is quite dependent on the United States economically (and not only).

India has shown impressive progress in recent years in economic development. But at the same time, just like Brazil, it has many social problems. And its interests are also regional and focused on South Asia and partly on Southeast Asia.

Russia possesses enormous military strength, great political influence and global interests. But numerous problems of its economy and social sphere do not give her the opportunity to bolster her ambitions economically.

So, neither the euro, nor the RMB, nor the Brazilian real, nor the Indian rupee, nor the Russian ruble will be able in the near future to pretend to challenge the dollar.

Equally, neither the Swiss franc, the Japanese yen, nor the British pound sterling can do this. These are niche currencies and their use will not change significantly.

So, what, then, will be the future monetary system?

We return to this issue in the final section of the article. But first, we will consider two more financial instruments which, by some opinions, have a great future - gold and cryptocurrency.

3. Eternal Sparkling of Gold

The crisis of 2008 showed that in a situation of instability and unlimited emission of reserve currencies and the volatility of securities, investors are beginning to actively buy gold. From 29/08/2008 to 30/11/2009, the value of gold increased from $ 833 per ounce to $ 1,175.75 per ounce, i.e. by 41.1464% [7].

Later, the price of gold rose even higher - up to $ 1,813.5 per ounce (08/31/2011) [7]. But it is the growth during the acute phase of the crisis that is important. It confirmed that gold remains a haven and anchor asset for investors. They are confident that during a crisis it is more reliable than currencies and securities.

Besides, from 30/09/2008 to 05/01/2019, the volume of gold in the reserves of central banks increased: from 29.961 tons to 33.976.5 tons [7], i.e. by 13.4%.

This trend has become particularly noticeable in the last 3 to 4 years. Central banks of developed countries have practically ceased to sell gold from reserves. Developing countries, first of all, China and Russia, increase its share in their reserves.

Finally, at the end of 2018 - the beginning of 2019, in a few international economic publications [8, 9, 10] there were allegations that the Basel Committee on Banking Supervision would reconsider its approach to gold as an asset. The basis of this decision is an agreement already allegedly reached within the framework of G-5 (US Federal Reserve, European Central Bank, Bank of France, Bundesbank and Bank of England). The authors argued that gold, currently attributable to banking capital of Tier 3 and estimated at 50% of its market value, will be transferred to Tier 1. This means that gold will be estimated as cash equivalent and top-rated debt securities, i.e. risk off asset.

A kind of slogan for these articles was the phrase "the re-monetization of gold."

There is no confirmation of this assumption, but its very appearance suggests that in the financial environment this idea enjoys a certain popularity.

Does this indicate that the return of the gold standard in its classic version is possible?

Hardly. First, the volume of emission of modern currencies is so significant that gold can cover only a very small part of the money supply. Secondly, in many countries the gold reserves are so insignificant that they will either must completely abandon the national currency or reduce the money supply to a microscopic size. Thirdly, the gold reserves of the United States are so huge and cannot be reached by any other country in the foreseeable future that it will again make the dollar a single world currency. And there is a lot of those who do not want such development of events.

But in the event of a sharp deterioration in the global economy, for example, as it was during the Great Depression in 1929-1933, gold could become the basis of both international reserves and international settlements. Its further fate will depend on the economic and political balance of power after the release of a possible new Great Depression.

4. A New Pretender – Cryptocurrency

The rapid development of cryptocurrencies and the blockchain technology, on which their emission and circulation are based, can really create a feeling that the era of traditional money is coming to an end.

As of 05/10/2019, the number of cryptocurrencies in international circulation amounted to 2,166, and the number of markets where they can be sold and bought is 18,212 [11].

And both figures are constantly growing over the course of several years, which clearly indicates the growing popularity of cryptocurrency.

So maybe one of the cryptocurrencies, the most common and causing the most confidence among investors, will take the place of the dollar?

This seems unlikely.

During the whole human history known to us, the role of money was performed either by objects with a high own value (for example, gold), or banknotes, confirmed by the economic potential of the countries that issued them.

When modern currencies are called unsecured, hinting at the absence of gold collateral, it sounds a bit naive. Modern money is provided with goods, technologies, intellectual capital, financial reserves, skilled labor, and the natural resources of the states that issue them. It is the quality and quantity of all the above, together with the economic policy of the issuer, that create the security for the national currency. The quality of this base determines the place of each currency in the world.

The role of the US dollar as a key element of the modern financial system is based precisely on the economic power of the United States, which is both the largest producer and the largest consumer of goods and services.

If we look at corporate securities, then here we will see an economic mechanism that is very similar to the issuance of currencies. The basis for making a decision on the purchase of securities by investors are the fundamental economic factors: the issuer's capital, the market share it occupies, competitiveness, profitability, the resources it owns, the liquidity of its securities.

None of the more than 2,000 cryptocurrencies is not secured. The only basis for their rise or fall is the desire of some investors to sell their crypto assets at higher price than these been acquired or purchased combined with the demand for them from other investors driven by similar motivation.

In other words, cryptocurrencies are monetary units without a foundation. It is impossible to create reserves or pay by pseudo-currency, the value of which you can neither estimate nor predict. This is too shaky ground to build a financial system on it.

In addition, the largest countries in the world - India, China, Russia, the United States, the key countries of Europe, Asia, and Latin America will never let go of one of the most important functions of the state - the organization and control of money circulation. And cryptocurrencies are private money.

At the same time, it is possible that if the collapse of the existing system will lead to financial anarchy, then cryptocurrencies can become quite popular for some time, until a new financial order arises.

But then everything will be back to normal situation. At all stages of human history, states sought to centralize the functions of the production and circulation of money in their hands.

Of course, considering the development of digital technologies, a crypto - dollar, a crypto - euro, and other cryptocurrencies based on existing currencies may appear. But these will be completely different cryptocurrencies, not private, but state ones. Both their release and circulation will be carried out on the basis of the same fundamental economic relations as the release of existing national monetary units.

5. The Most Realistic Scenarios

Most likely, the coming decades will bring big changes in the global financial system. While dollar position looks the most preferable. Behind him is the established structure of international reserves, payments and settlements. Behind him - the economic, political and military power of the United States. Behind him is the force of inertia, the power of human mistrust and resistance to the new and the unknown.

But this system is leaving, since it is inadequate to the new time and the new balance of power in the global economy.

Currently, there is no currency that can replace the dollar. But it will happen. And, most likely, one of two ways.

The first is that one of the currently existing states, the most powerful one, will inherit the role and place of the United States in the global economy and politics. And its currency, too. I think this option is unlikely.

Second, there will be a combination of the largest and most influential states in economic, political and military relations (including, most likely, the United States), which will create a new global financial order based on several strong currencies.

Obviously, either of these two paths will be difficult, as it is to go through the collapse of the existing monetary system.

The existing global financial system is a kind of iceberg that is melting. In the interests of all participants in the global economy that this melting was slow. This will provide an opportunity to better prepare for the new system and try to make its arrival as painless as possible.

But the collapse of the existing system can go very quickly, both under the influence of the deepening crisis in the economy, and under the influence of non-economic factors - political, social, military.

Therefore, the main task of the governments of the G - 20 countries and international financial organizations is to show responsibility and the will for constructive cooperation in reforming the global financial system.

6. Acknowledgement

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