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THE GEOPOLITICS OF THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM

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Tacitus wrote about empire. Unlike his predecessor Livius (known to us as Livy), we --- from the Italian city states to the American founding fathers --- haven't looked to him for inspiration about republican constitutionalism but, rather, for instruction on the exercise of dominant power. As he says in the *Histories*, peace depends on armies, but troops need paying, and that requires taxation. He might have added that taxation is umbilically tied to state money, and that if a sovereign's money is used abroad as well as at home, their hard power is supplemented by symbolic power. This is highly germane to the geopolitics of today's international monetary order, and I shall return to it in my conclusion.

Tacitus was also interested in Britain, his father in law having re-consolidated Roman control after Boudicca's uprising. As well as noting the principle of gender equality in our ancestors' norms of regal succession, he describes our island as rainy, cloudy, occupied by people from across the continent, faction ridden, and strongly superstitious. That, I should say, will be my only mention of the UK this evening. In discussing the geopolitics of the international monetary and financial system, I won't be touching on the UK, explicitly or implicitly. My focus is on the big blocs whose fortunes, constraints, objectives and choices will drive the world's monetary and financial order over the coming half century. So let's jump 1900 years, to the early-1970s[1].

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[1] My thanks for comments and/or exchanges on various parts of this to Mark Blyth, Steve Cecchetti, Niall Ferguson and Paul Volcker, none of whom is responsible for the content or messages.

Politics and the international monetary system

In 1971, John Connally, a Texan politician who had become President Nixon's Treasury Secretary, famously told his international peers, the world's leading finance ministers, that the dollar "is our currency, but your problem". Whatever he had in mind, he had a point.

Given this was nearly half a century ago, it might be worth recalling that Connally, a former Democrat state Governor who had survived serious wounds when President Kennedy was assassinated, was widely regarded by friends and foes alike as a formidable politician. By his own admission not an economist, he was most certainly a tactician and strategist. His 'it's your problem' statement in late 1971 put this on display.

Almost a decade earlier, President de Gaulle had exercised France's right to demand gold in exchange for its dollars. That came not so long after Suez and a little before de Gaulle pulled France out of NATO. It was a signal of discomfort with US leadership, and that France at least thought the US was not strong or disciplined enough to sustain the value of the dollar. Later in the decade, the very possibility of countries enforcing the US's monetary obligations might have exposed fragilities in funding its escalating Vietnam War.

But Connally had a sense of timing, and a clear appreciation of the paucity of options available to his international partners. A few months *before* the Treasury Secretary made his famous remarks, the US had suspended gold convertibility. For the many countries that had held onto their dollars, this meant substantial losses if the dollar depreciated. They weren't happy, but didn't have many options. With the Cold War near its peak, West Germany in particular was dependent on the US to protect them from the Soviet Union, and no other country was remotely in a position to step up to the plate as a new anchor currency. The US could be confident that, once a new regime was patched together, the dollar would remain the world's predominant reservecurrency. When that moment came, the US lifted the import tariffs it had imposed to prop up its external position and transmit costs to its international partners. Even if just a negotiating tactic, those measures had amounted to an exercise in raw power.

But the new regime was, as it turned out, a problem for the US too. With oil priced in dollars, the currency's depreciation put pressure on the incomes of the big Middle Eastern oil producers, who finally called an embargo and pushed prices upwards in the wake of the Yom Kippur war. Unable or unwilling to control the resulting domestic inflation, US economic performance suffered. In a period of what became known as stagflation, the economy provided no respite from the political turmoil brought by Watergate and withdrawal from South East Asia. By the middle of the decade, learned reports were being devoted to The Crisis of Democracy. Eventually the US had to endure a back-breaking recession and resumed fiscal discipline in order to restore internal monetary order and, thereby, underpin the dollar's international role as the financial component of its global leadership. Over much the same period, policies on oil exploration and dependencies were recast somewhat.

The point of that story is to underline how intricately intertwined the international monetary order is with geopolitics, and how this plays back into the domestic economic policies and politics of the anchor-currency country. It sets the stage for some reflections on the possible evolution of the international monetary and financial system over the coming quarter of a century or so.

In a way, my message this evening is simple, even rather mundane. That the fields of economic policy and foreign policy occasionally converge, and that we are in one of those phases of history. It is worth saying only because they are relatively rare.

Of course, there are areas of engagement, notably the use of financial sanctions in geopolitical stand-offs. But, taking everything together, a striking thing about the operation of government is that most of the time foreign policy and economic policy inhabit separate spheres, not just day to day but strategically. Moreover, they are spheres occupied by distinct tribes or castes, who have been trained differently, think about the world differently, and draw on separate networks of power and influence. They have their own think tanks, are monitored by a largely segmented commentariat, and not infrequently have distant relationships within government.

That has already been changing somewhat in the field of trade policy, with plurilateral accords being struck as part of broader regional policies. But the economic community proceeds on the basis that the international monetary system is their preserve, and the foreign policy community as if it doesn't matter much. Whether for those or other reasons, it is worth recalling that Secretary of State Kissinger was not told in advance when the US did finally abandon gold.

But government in separate spheres doesn't always work. When the deep architecture of the monetary system is in flux, the big issues are not so easily parceled out to different buildings. At such big moments, when the global economic order is either consolidated or reshaped, they come together, either in collision or strategic concord. It is by no means certain, but this generation might live through such a moment and policy needs to be framed, explained and executed accordingly.

An international monetary and financial system in flux?

The international monetary and financial system (IMFS) is being transformed in the wake of the 2007-09 crisis and, separately, by the emergence of a new geopolitics.

This was, very likely, the last global financial crisis where the subsequent reform agenda is framed largely via deep transatlantic relationships. Many of the rising economies already have a seat at the table, via the Group of 20 (G20). Next time round, they will be active, perhaps leading participants.

And next time, we might, for the first time in well over a century, live in a world with parallel reserve currencies; and in which the major banks and other globally active intermediaries might be domiciled across the whole world rather than, as now, largely in the US, London, Switzerland, France and Germany.

The geopolitical foundations of the current international monetary system

To have a chance of understanding where we might be going, it helps to understand where we have come from.

If, as I have recounted, the dollar survived as the world's reserve currency notwithstanding the untidy demise of the Bretton Woods system, that tells us that deeper forces and considerations were at work than the relative merits of fixed- versus floating-exchange-rate regimes.

This can get lost when we look back to the 1944 Breton Woods conference that introduced the gold-exchange dollar monetary standard for the post-WW2 world. It is natural to focus on Keynes' grand designs and intellectual brilliance; on Harry Dexter White's policy realism and strategic and managerial acumen; and on the competition between them, as well as on White's second job as a Soviet spy. It is, in consequence, easy to overlook the great foreign policy *dictat* that preceded and was a precondition for the great gathering of dozens of countries in New Hampshire's White Mountains. US Secretary of State Hull had insisted that Britain's system of imperial preference should be taken apart. President Roosevelt had not finally brought the US into the war in order to return home with our Asian empire more or less restored.

Indeed, in the grand sweep of history, we could see the post-war international monetary order as predicated upon two grand bargains. First, the dollar succeeded sterling as the world's reserve currency and the European powers abandoned their colonial projects; and 'in exchange', Europe outsourced (leadership of) its defence to the US, via NATO. Second, the marginal supply of Middle Eastern oil gradually moved to being invoiced and traded in dollars, and 'in exchange' the new world hegemon acquiesced in the Saudi Arabian secular elite's accommodation with its local religious authorities.

Of course the equilibrium international monetary and military order has been hugely more complicated than that. But, in this part of the world, the countries of Europe have been able to pursue their affairs taking that wider global backdrop as a given, allowing preferences for leisure and the good life to be expressed as never before.

It has, further, been and remains a world order where, to put it boldly, the baton of leadership passed between allies who, despite family differences and aggravations, draw on shared histories and cultures. A world in which, in the economic sphere, Europeans have been leaders at the International Monetary Fund and, perhaps especially, in designing and reforming the system of financial regulation that emerged following the shift during the 1970s to floating exchange rates and, later, unimpeded cross-border capital flows.

Prospective change

Now that settled world might be changing, with the remarkable growth of emerging market economies that are, by now, rather more than 'emerging'. Even though their per capita income levels remain well below those of the West, already China and India are big parts of global output and trade, and officials from countries as widely dispersed as Mexico, Brazil, Korea and Malaysia are serious players in central banking and finance ministry councils.

This is a world, more to the point, in which new reserve currencies might emerge alongside the dollar. We see that in the infrastructure to support renminbi transactions and trading outside the People's Republic, in the currency's addition to the SDR basket, and in central bank Governor Zhou's public thoughts about the future of the international monetary system[2].

It would be surprising if China did not entertain such thoughts or plans. Much is made of the world reserve-currency issuer's 'exorbitant privilege', a label coined by Valery Giscard d'Estaing 1960s during the height of French/US tensions in the 1960s. The reduced funding costs are plainly worth something. They might be seen either as a subsidy to American consumers and businesses or, alternatively, as part of the broader geopolitical settlement I described, in which symmetry is maintained through Europe (and Japan) financing the US's external deficits in return for its support in post-War reconstruction and defence.

Those considerations might or might not seem germane to any new world order. Of continued relevance is whether any 'privilege' is balanced by a 'curse', as posited in a dilemma made famous amongst economists by the Belgian-American Robert Triffin. Under fixed-exchange rates, the reserves-issuer must meet external demand for its currency. Under floating exchange rates, there is no formal obligation, but still *de facto* forces that in practice are hard to resist, potentially entailing destabilizing cumulative current account deficits. But no global leader in modern times has voluntarily foregone the opportunity[3].

Quite apart from geopolitical returns, issuing the primary reserve currency also provides an economic and, thus, domestic political insurance policy against big economic shocks. Even in the face of a national and international crisis sparked by US sub-prime mortgage improvidence, US Treasury bonds rallied, reducing the cost of government debt just as fiscal support was provided to cushion the blow for the American people --- and this despite the fact that the US had been running

[2] Zhou Xiaochuan "Reform The International Monetary System", People's Bank of China, March 2009.
[3] For exorbitant privilege, the classic text is Belgian economist Robert Triffin's **ref**.

a sizable external deficit for years and has continued to do so. Having such a shock absorber to help them get through their biggest domestic economic and financial crisis for nearly 80 years, must have struck US officials and legislators as providence indeed. And it can hardly have failed to be noticed in the capitals of the rising economic powers.

The prospect or, perhaps more accurately, the possibility this creates is a multipolar world of parallel reserve currencies. In the past, as in the last part of the 19^{th} century, such moments have been rather tense. But the capitals of the new world are no more destined to revisit the missteps of the European past than in our part of the world we are destined to be caught frozen in the difficulties of the present.

Tensions within the current IMFS

A foreign policy specialist might now get into the substance by discussing the economic implications of the Sunni/Shia struggle, the rise of China and the dynamics of the South China Sea, Russia's geopolitical strategy and tactics, and perhaps the fate of liberal democracy in Latin America's presidential political systems. My way in is obviously from the other end. To help set the scene for four possible end-points, I am going to sketch a few of the awkward dynamics in the current international monetary and financial system.

In doing so I will unbundle three sets of issues: the drivers and consequences of the pattern of *net* capital flows, which can be thought of as the territory of macroeconomic policy; the composition of the underlying *gross* capital flows, which can be thought of as macro-financial; and, third, the interconnections amongst internationally active financial intermediaries, which can be regarded as regulatory. The three fields are characterized by politics that are, respectively, impotent, angry, and obscure. Under each heading, therefore, I will try to bring out just a few of the broader international and geopolitical complications.

The impotent politics of global macroeconomic imbalances

In the years running up to the financial crisis of 2007/08, the world economy was plagued by persistent imbalances in the pattern of trade. Big picture, the US along with some other Western nations ran external deficits, while China and others ran massive external surpluses. The counterparts were, by definition, in savings/investment imbalances. While the expansion of domestic investment in China during this period was quite extraordinary, it could not keep up with the growth in savings. On a current orthodox view that I broadly share, this led to a compression of global real interest rates, and that in turn pushed up asset values, providing the collateral that helped fuel (but, to be clear, was not the sole cause of) the credit boom that paid for the West's consumption splurge.

Rather than the letting its currency appreciate, which might have kept the external position closer to balance, the Chinese state intervened to hold down its value against the dollar and other currencies, accumulating a vast portfolio of foreign exchange reserves in the process. The post-Bretton Woods system of floating exchange rates hadn't catered for a rapidly expanding economy that, for domestic reasons, preferred to more or less peg its currency. All this prompted attempts in the US Congress to pass retaliatory legislation, which were opposed by successive Administrations who saw value in incorporating and inducting China into the international system gradually and peaceably.

Following the 2008 crisis, one of the reform programmes established by the G20 was to examine the workings of the International Monetary System (IMS) to see whether it could operate without entailing persistent macroeconomic imbalances. Those efforts got nowhere, slowly, basically because officials got stuck on the inevitable issue of how to get to a world of more symmetric adjustment. Guess what, the surplus countries didn't want to play ball.

Many economists regarded all this as the height of irrationality. Mercantalism doesn't work, they said, arguing that it was in China's own interests to rebalance its economy towards consumption and away from exports. Mercantilism works *for the mercantilists*, I responded: travelling around the English countryside, you can see evidence of that in families still living in the great houses built or extended by their mercantilist forbears. It is difficult to persuade the alliance of political and business interests that drives mercantilism to change course until its unsustainably is painfully evident, by which point the adjustment is more complex. Some commentators argue that China missed its best chance to adjust smoothly. In fact, once politics is allowed into the analysis, it becomes obvious that it is never easy.

But to be clear, the problem of imbalances wasn't just about China. Any summary of international gatherings in the years before the crisis would have to include the strictures on Germany to consume more, the pleas for the US to save more (that's to say, spend less), and the urgings for continental Europe to liberalise its services sector and labour market.

If anything, the pressures on the surplus countries intensified after the crisis, since they had the capacity to support spending in the global economy as a whole. Faced with declining demand in the US and Europe, China acted to sustain improvements in its people's living standards. It chose to spur domestic activity partly through a credit boom that is itself now deflating, slowing the economy and so reducing demand for foreign imports, including German engineering and French luxury goods.

The moral of the story is that it is hard for surplus and deficit countries to see their shared interests, and even when their leaders do so, it is hard for them to convey that to their domestic constituencies. It is not fanciful to think that we will go round this course again a few years' time (if and) when India or some other long-slumbering giant full of potential grows to be a meaningful part of the global economy and has to balance domestic development imperatives against its longer-term interest in global macroeconomic health.

It was ever thus. At Bretton Woods, Keynes never had a chance of persuading the US to adopt a system of symmetric adjustment. We, the UK, simply owed them too much money, having mortgaged ourselves to provide a platform to fight for civilisation and liberty (in the great arc of history, not a bad way to vacate the summit). Similarly, within Europe today, the south takes the burden of adjustment given its indebtedness to the more competitive and productive north, and waits in hope of the north needing help on some other front --- perhaps border controls.

And at a global level, an important background factor to the prospective balance of power has been US indebtedness to China, Japan and the oil-producing countries. Would this eventually lead to credit rationing of the US in a 'game' played out in many spheres and seas around the demise of *Pax Americana*? Or, alternatively, would creditor nations find themselves disposing of their reserves in order to hold up their currency?

With the PRC deploying perhaps around a trillion dollars of reserves over the past year, it looks more like the latter for now. But why not let the renminbi depreciate? Quite apart from the economic arguments and dilemmas that rightly preoccupy economists, would a sharp depreciation adversely affect relations with its regional neighbours during an already tense period in the South China Sea? Or is depreciation unattractive because it would damage those of its businesses that have borrowed heavily in dollars, with the implication that intervention is a form of indirect fiscal support?

That last consideration moves the story on from a one-dimensional world of current account imbalances. It brings in the *composition* of a country's capital flows and, therefore, national balance sheets.

The angry politics of global capital flows

A remarkable feature of the net capital flows that are the counterpart to the current account imbalances I have been describing is that, in the surplus countries, the deployment of excess savings was largely under the control of state entities whereas, in the deficit countries, the cumulative indebtedness represented an aggregation of public and private sector external financing. Preferences therefore made a difference.

For the surplus countries, this mostly meant investing in the debt securities of low-risk sovereigns, which some believe contributed to a shortage of 'safe assets' that was plugged by the boom in securitizations. But we should recall that when sovereign wealth funds moved into buying whole companies, there were occasionally concerns about foreign governments controlling strategic sectors or facilities. In other words, deficit countries exposed themselves to political discomfort or financial excess, and occasionally both.

From a macro-financial perspective, time and again policymakers have had to be reminded that *gross* capital flows matter as well as net flows. In the 1990s Asian crisis, the sectors under pressure varied according to who had borrowed short term in foreign currencies in external markets. In Thailand, it was the government; in Korea, the banks; but in Indonesia, the non-financial corporate sector. The rapid withdrawal of hot money triggered liquidity and exchange-rate-regime crises. In addition to the virtues of floating exchange rates, lessons included the importance of monitoring and managing *national balance sheets*.

This entailed some combination of avoiding excessive foreign currency borrowing and holding larger fx reserves. Perhaps because of difficulties in constraining the private sector while allowing free capital flows, many EMEs put the stress on accumulating fx reserves to build a "fortress balance sheet". In other words, they chose to self-insure against shocks rather than rely on external insurance from an IMF they thought insensitive to their predicament.

Because this strategy was so widespread, it added to the excess demand for safe securities and, perhaps, to the excess of global savings. Hard luck to the West, one might say. Except that when boom turned to bust in the West, the extraordinary easing of monetary policy sent capital hurtling towards the EMEs. They had insulated themselves from one set of idiosyncratic problem, but not against the global disequilibria to which they, along with the West and China, had contributed.

The trials of both the Asian EMEs in the 1990s and of the euro area during 2011/12 are examples of capital flight exacerbating home-grown problems. But capital does not flee solely due to crisis in recipient countries. Problems might begin in the providing countries, as when euro-area banks withdrew capital from south-east asia in order to buttress their home business. Or volatility might not be prompted by problems at all. Arguably most frustrating for recipients, and certainly most important to my theme, there might simply be an abrupt and disruptive 'rotation' from one set of opportunities to others: game over, move on. That has come to the fore as short-term capital, following the dictates of the cross-border carry trade, flowed with the rhythms of US monetary policy. First, capital poured in to a number of EMEs, pushing up exchange rates and asset values, loosening internal credit conditions, which it was hard to combat with tighter monetary policy without adding gravitational pull to the movement of hot money. And then it flowed out as the monetary policy 'cycle' in the United States began to turn.

Diplomatically speaking, perhaps the least constructive response from the West has been along the lines of: why are you complaining now when you complained at the capital flowing into your countries in the first place. That misses the point: one of the reasons for concerns about hot inflows is that the recipients know only too well that sooner or later they will reverse almost as quickly. Rightly or wrongly, it seemed insensitive to EME policymakers and commentators.

In terms of geopolitics, there have been two broad responses. One, spearheaded by Raghu Rajan, Governor of the Indian central bank, has been to argue in a series of public interventions that Federal Reserve policy makers should place greater weight on the effects of their policy choices on the rest of the world. He maintains that this in the US's self-interest given that these economies are now meaningful for global demand and, separately, that it is entailed by the responsibilities and moral duties the US bears as the issuer of the world's reserve currency. This is very explicitly an intervention around the basis for the legitimate authority of the monetary hegemon.

The second response, articulated most forcefully by Olivier Blanchard and his former research team at the International Monetary Fund, is that the world should move to a quite new IMFS that incorporates controls on short-term capital flows and, especially, flows of debt finance. The challenge, as I see it, is how that could be achieved without risking the creeping protectionism that undid the world economy in the 1930s. But, that aside, these proposals amount to technocratic manifestations of the shifting tectonic plates of global power. We are no longer talking only about the effects of G3 monetary policy on the rest of the G7.

The obscure politics of the international financial system

When we come to the third element of the IMFS --- the financial system in the more familiar sense of financial institutions: banks, dealers, insurance companies, funds, etc --- things change. So long as we are talking about macroeconomic policy, each country can collect the information they need to make what are, in a world of floating exchange rates, essentially domestic policy decisions. But when it comes to supervising internationally active financial firms, national authorities are hugely dependent upon each other.

That has been known for decades, which is not the same as saying that it has been cured.   But a new challenge beckons. If, as part of the newly fashionable world of macro-prudential policy, regulators dynamically adjust regulatory requirements to maintain the resilience of their financial system, they are going to have to reach views about the threats posed to 'their' firms' by exposures to and in other economies. As well as intensifying the existing informational dependency, this means that their published policy decisions will give signals about the state of other countries' financial systems and economies.

Concretely, if in the mid-2000s European regulators had raised capital requirements against US sub-prime mortgages, they would have been signaling that something was awry there. Similarly, if the US had raised capital requirements against euro-area sovereign or banking exposures, that might have brought forward Europe's own crisis. As I have argued in a paper written jointly with Steve Cecchetti, this is a world in which information exchanges may not be enough. Active cooperation and possibly even policy coordination may be needed, which would be a big step[4].

Signs of the underlying issues and potential tensions have been apparent in the political response to some of the support operations undertaken during the 2007-09 phase of the crisis. US legislators and commentators complain about the Fed having provided lender of last resort support to non-US banks, and extending dollar swap lines to European and other central banks. This is serious.

One might respond that a readiness to lend dollars is unavoidable if the dollar is the world's reserve currency, and if the US is to avoid calamitous feedback from foreign crises into its own economy. But another possible response would for countries to insist that their banks reduce their use of the dollar, in case the Fed is one day unwilling or unable to ensure that the global dollar system clears smoothly.

[4] Cecchetti, Stephen G. and Paul M.W. Tucker, "Is there macro-prudential policy without international cooperation?" CEPR Working Paper 11042, January 2016. http://people.brandeis.edu/~cecchett/WPpdf/2015_Cecchetti_Tucker.pdf

Those issues can only become more pointed as and when the class of unquestionably globally systemic firms widens to include groups domiciled outside Europe, the US and Japan. Right now, the so-called SIFIs are generally domiciled in strong economies with deep fiscal capacity. What happens if SIFIs emerge in economies that become very large before they are similarly strong?

A quite separate set of questions, but one that might prove similarly awkward, arises around the territorial reach of regulatory policy. Whether or not this is strictly accurate, there is a perception that if an entity in, say, Melbourne trades in a dollar-denominated contract with an entity in, say, Manilla, US authorities might claim jurisdiction for some purposes given that the dollars must ultimately be settled across accounts in the United States. That may make sense, but in a way the burden of my message is that the regime needs to be designed after weighing the possibility of other countries in the future claiming jurisdiction over trades in their currency between parties in, say, Massachusetts and Memphis.

Can those issues be addressed only by each country's currency being used only within its borders or by authorities claiming reduced territorial jurisdiction. In the former case, there is no world reserve currency. And for the latter to work, authorities would need deep levels of trust, which in the field of derivatives has proved arduous even between the US and EU. A system of mutual recognition calls for granular global standards that are not so granular that a superfluity of detail shows the way to avoidance and evasion. Not an easy task.

Four possible endpoints for the IMFS

If, as I suggest, the future of the international monetary system will both be determined by and itself influence geopolitical dynamics, it is impossible to make predictions. Instead, I will sketch four broad possibilities, starting with a continuing dollar standard, since incumbency has obvious advantages.

a) A dollar system under a modified Washington consensus

Continued dollar centrality is most likely if the US economy performs well, and if the US exercises its power prudently, prudence being the virtue in power-holders most stressed by Tacitus.

Performing well includes continuing to be the world's engine of technical innovations that drive productivity improvements; avoiding boom and bust, and especially another US-led global crisis; and long-run fiscal and external sustainability, so that it can sustain the costs of the *Pax Americana*. These three ingredients are of course related. A dynamic economy and a lower household sector propensity for excessive borrowing would provide more fiscal space for the US to maintain its external burdens.

To exercise its power prudently, the US would need to keep its eyes fixed upon its long-run interests, which would mean sometimes accommodating the interests of other major blocks or seeing how they played back into US interests and welfare. One can see here that economic policy isn't just for technocrats.

So this would be a world in which Middle Eastern oil suppliers did not conclude that, on balance, they should switch to invoicing oil in a currency other than the dollar. It is a world in which, somehow or other, the US navigates a complex relationship with the Sunni and Shia powers, which of course it is attempting.

It would be a world in which the importance of the pattern of *gross* capital flows and of the structure of the *national balance sheet* did not get lost again. That needs to be institutionalized into IMF surveillance and advice[5]. But beyond monitoring, it needs to be reflected in policies that make clear who can prudently run sizeable dollar shortages. Concretely, that calls for precisely the kind of pre-agreed swap lines that have been entered into by the Fed (and the ECB) with other central banks in recent years.

[5] David Li (China) and I advised the IMf on this during 2014.

Things become interesting under this first scenario where significant countries do not have access to a swap line, perhaps because they remain too risky for the Fed (or the ECB) to accept their currency as collateral. This opens up three vistas.

Such a country might curtail the dollar (and other fx) obligations of its financial system and, where necessary, of its real economy. That would amount to a prudent national balance-sheet policy, and should be encouraged by the IMF. Or if it is big enough, such a country might play moral hazard chicken with the US, gambling on the Fed providing dollars *ex post* in order to contain worse spillovers to the US. That would be a systemically imprudent policy, and should be discouraged and called out by the IMF. And a third course would be for such a country to move towards using another reserve currency, seeking a swap line from there.

That third course opens into the world of geopolitics, and potentially renders the first scenario unstable. Swap line-shopping would not just be about economics. The US might find itself wanting to grant swap lines in order to sustain a dollar-based international system.

b) *Rival reserve currencies in a tense world*

The second scenario is a limiting case for that dynamic, with rival reserve currencies and overlapping zones of influence. This multipolar set up is a world where the public good of a single numeraire and common medium of exchange for international economic activity begins to unravel.

It is also, quite obviously, potentially a tense world: one in which two economic super powers might vie for influence and clout economically and politically. It is a world in which the currency politics of Asia become ever more entangled with the territorial politics of the South China Sea and with the development politics of Africa and Latin America.

In this world, the dollar's status would be reduced, and there would be rival extraterritorial claims in financial regulation. The main currency issuers would reward allies with currency swap lines, and would seek to keep others tied to them by encouraging wide use of their currency. It would be a world of fierce competition for placements and patronage within the main global institutions.

It would also be a world in which other, lesser powers would seek tactical advantage in the interests of local or regional clout, and might even seek to play one great power off against the other. It would therefore be a world in which every step in monetary and regulatory policy might inadvertently be a move in the 21st century's Great Game. There would accordingly be a premium on clear rules of the game domestically, reducing the risk of false motives being ascribed to policy choices.

It would, in short, be a world in which the capitals of two economic super powers would need wisdom; prudence would not be enough. International monetary officials would need to be 'monetary diplomats' once again.

c) A multipolar top table in a world of checks and balances

The third broad scenario is a world in which a number of other countries are successful enough to sit at the top table. In many ways, the future of the world might turn on the fortunes of India, Indonesia, Brazil and others. But there is a question about Europe too.

In 2011 I attended the ceremony in Frankfurt to mark the passing of power at the European Central Bank from Jean Claude Trichet to Mario Draghi. Amongst the many remarkable speeches, Chancellor Merkel made comments that struck many of those present. As I remember them, and I should stress that I have not checked the text, there were four key points, which I would put as follows:

- It is wonderful to be part of a world in which so many EMEs are lifting hundreds of millions of people out of poverty.
- This will be a world in which the global Top Table covers the planet. It will include the US and, likely, China, India and perhaps others. Europeans should want to be at that Table.
- Germany has enjoyed a sustained period of economic success, drawing on the human capital of its people and their willingness to make some important structural reforms.
- But in the new world we are headed towards, Germany is unlikely to be big enough on its own, however successful in per-capita terms, to be at the Top Table. That will take Europe as a whole to be a success.

Of course, Europeans are likely to keep their seat(s) at the *de jure* international tables for some time through the inertial force of incumbency. But the question is whether Europe will be at The table, the ones that matter. It is hard to see that absent profound reform.

Those reforms obviously need to make the monetary union sustainable: some kind of more overt fiscal union to replace today's opaque risk-transfers via the payments technology, and a system that makes it feasible for a member state government to default *within* the monetary union and which incorporates fiscal discipline . Beyond that it vitally requires reforms to reinvigorate growth: structural and liberalizing reforms. None of this will be easy, not least given the standard of living enjoyed by those citizens who vote.

But to distinguish this from the second scenario, let's assume that all that happens. This is a world in which the role of the dollar might be sustained as a matter of choice by the other economic powers. As a quid pro quo and given global stretch in peace-keeping, the US might require Europe to make a greater contribution to its own defence, underlining the imperative of renewed European dynamism but adding to that the prospect of a loss of leisure time.

As with the first scenario, this world would also require adjustments in the international rules of the game for the IMFS, but with the difference that leadership of international institutions would either rotate amongst the Top Table powers or would move to the marzipan layer of countries that were big but not amongst the biggest.

d) Protectionism and autarky

The final scenario is one of retreat into economic and financial protectionism, even to autarky, while the great powers, few or many, struggled for strategic and military supremacy. This would be a dangerous and impoverished world, as the economic and civilizing benefits of international trade eroded. It is not a world anyone would design or plan for, but one into which we could slip.

We start off in a good place. History will remember the anti-protectionist sentiments of the G20 Summits held in late 2008 and through 2009. In effect, the Leaders held hands and committed to each other and to the people of the world not to make the protectionist mistakes of the 1930s.

But it takes work to hold that position. Some of that is technical, and part of the technocratic work concerns the IMFS.

For example, unless the available and enacted solutions to the problem of Too Big To Fail financial institutions are truly embedded and executed when called upon, these institutions will remain, as Mervyn King memorably put it, “international in life but national in death”. For the international financial system, that is a world of segmentation and withdrawal.

Unless macro-prudential measures can insulate relatively small open economies from the costs of violent capital flows, capital controls will creep back in.

Unless monetary policy makers can convince politicians that, in a world of floating exchange rates, monetary easing is not a form of currency war, such controls could become attractive to big economies too.

If this seems fanciful, just think of the policy dilemmas currently faced by China, and the political and economic pressures in Brazil and Turkey.

e) Finding a path: chance and design

Of those four stylized scenarios, the first and the third should be more attractive than the second and fourth. More attractive, that is, for anybody other than those who see themselves as prospectively benefiting from disorder and tension, and we will be lucky if no one falls into that category.

But what great forces will determine where we end up? In my introduction, I referred to objectives, constraints, choices and fortune. Our landing point might turn upon who makes the bigger mistakes.

What I hope to have persuaded you of is that those mistakes might not only be in the substance of economic policy, but in its diplomacy. Such diplomatic slips might range from how economic policy affects the substance of other spheres of international governance to, rather more simply, its tone.

Of course, relative performance will likely dominate, but I hope policymakers will give some priority to the risks of being misunderstood, to offending when no offence was intended, and therefore to the immensely complex task of understanding the world we live in and how others see it.

More concretely, it means adopting policies having assessed the following. Either one would accept the policy being reciprocated by others in a world where their power increases --- my second and third scenarios --- or one believes the policy will cement the current world however much trouble it causes elsewhere. Tacitus' prudence has a role to play here.

Summing up

The perspective I have offered here is quite different from the standard view of economics. That view was expressed eloquently by Ben Bernanke in last year's Mundell-Fleming lecture at the IMF. I want to quote a chunk of what Ben said:

> "Overall, the dollar standard appears to provide a global public good, and the rents to the United States of providing that public good seem much diminished, at least relative to the Bretton Woods era. With the benefits to the users and provider of the dollar standard less asymmetric than they once were, we shouldn't be overly exercised over controversies about whether the dollar will retain its pre-eminence, the future of the renminbi as a reserve currency, and so on. These debates are more about symbolism than substance. In purely economic terms, the universal usage of English, say, is far more valuable to the United States than the broad use of the dollar."

It doesn't take more than a moment's thought to identify the differences in emphasis in my remarks this evening. The English language is highly valuable to the UK too. But we don't control it. Nor does the US control English, but it does control the dollar. Maybe the dollar's broader value to the US is only symbolic, but I rather doubt that it is a symbol that Congress or the American people would discard willingly or proactively. That is because along with the soft power of its cultural institutions, the power associated with the dollar --- economic, financial or symbolic --- complements and reduces reliance on its hard power. That doesn't so much mean that Ben was wrong as that, as 20th century anthropologists and sociologists stressed, symbolic power is potent. Whether the *Pax Romana*, *Britannic*a or *Americana*, a lot of the peace we value is sourced in norms and conventions. I suspect that Secretary Connally was well seized of that.

Decades pass during which monetary policy and foreign policy proceed in largely parallel universes. Those are the decades in which not only the balance of power but the institutional forms that instantiate the international order are broadly settled. It seems unlikely that that is the world we shall live in over the next quarter or half century.

As I said at the outset, in many ways my message is simple and mundane. If nothing else, policymakers will be reading the sections of newspapers and blogs dedicated to other parts of government. Or at least I hope so!