A personal take on science and society

World view

By Ann Pettifor

Rebuild the ramshackle global financial system

Economic researchers neglect the role of financialization in global existential crises.

Riddled with comorbidities, the current global monetary and financial set-up precipitates crises with increasing frequency. At first, these were on the fringes of the global economy; in 2007–09 they moved to its very core.

Since 1971, national economies, and all our lives, have been shaped by this 'system', which can be described only as ramshackle. In that year, US president Richard Nixon unilaterally dismantled the Bretton Woods international financial architecture, built at the end of the Second World War. No sound replacement was constructed. Largely privatized, what governs the global economy today is mostly deregulated and made up of an ad hoc set of legal arrangements.

The financial system's role in driving global connectedness has led to many changes: radical innovations in information and transport technologies; the greater integration of trade and business; and rises in living standards. However, the system has resulted in greater fragility. Financialization of the global economy plays a part in transmitting pathogens by financing long supply lines and international transport networks. These impacts are barely understood by policymakers, and are rarely discussed by mainstream economists.

Instead, academics are preoccupied with theories centred on the nation-state. Most focus primarily on microeconomics – the study of individuals, households and firms – and their relation to government. Too few tackle macroeconomic questions of cross-border capital flows; the role of central bankers in overseeing and making global financial markets; or the dominance of the US Federal Reserve in global governance.

Nor is there sufficient interest in the US dollar's often maligned role as the world's reserve currency, which must be held by many countries to make payments to other countries. When speculators 'fly' from investment in one country and convert their holdings into US dollars, the original currency plummets, raising the cost of imports such as oil or pharmaceuticals. This is not new. Countries are periodically rocked by stampedes of such cross-border capital flows. The 'exorbitant privilege' exercised by the US dollar accelerates such stampedes. Action by the Federal Reserve can only briefly ameliorate these shocks, because of this volatility.

New lines of research into financial globalization are needed to manage domestic economies in these challenging times and mitigate the impact of future crises – from pandemics to climate breakdown and biodiversity collapse. Among the most important studies will be those leading to the development of a new, better-managed international financial architecture.

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The possibility of such a transformation to ensure stability and sustainability is largely absent from academic and public discourse. The 'rethinking' after the 2007–09 global financial crisis led simply to a consolidation of the existing system. As the International Monetary Fund (IMF) explained in its April 2020 Global Financial Stability Report, after that crisis, the US Federal Reserve, far from limiting excessive credit creation, turned a blind eye as private credit markets expanded and reached US$9 trillion globally. As with the 2007–09 crisis, lax regulation by central bankers lowered borrowers' credit quality, and weakened underwriting standards and investor protections. These risky credit markets – in high-yield ('junk') bonds, leveraged loans and private debt – showed stresses through early April 2020, despite the Federal Reserve's massive cash injection. The stimuli have once again bailed out monetary chicanery more than they have individuals.

Reform is crucial if societies north and south are to mobilize the financing needed to import drugs and equipment to tackle this pandemic and future ones, let alone if they are to fight climate change by investing public resources into alternative and sustainable transport, land use and energy systems. During the COVID-19 crisis, private markets failed to supply timely necessities, such as personal protective equipment. In the same way, before this pandemic, the market proved unable to provide affordable health care, housing and higher education, as well as decent well-paid jobs, for millions of citizens. Private markets are not fit to guarantee the security of populations in the face of increasingly dangerous extreme weather events.

Just as we need a sustainable global ecosystem, so do we need a stable, sustainable international financial system – an important public good. The next practical priority, therefore, is to ensure international coordination and collaboration in designing a new architecture.

When the international system was last reconstructed at Bretton Woods, New Hampshire, in 1944, US president Franklin D. Roosevelt invited only qualified economists to the conference. Bankers and financiers were barred. And the selection of experts was broad – not narrowly focused on Anglo-American academia. Roosevelt ensured that scholars represented diverse geographical regions and interests: 32 of the 44 delegations came from low-income countries. As political scientist Eric Helleiner explained in his 2014 book *Forgotten Foundations of Bretton Woods*, policymakers were "deeply committed to an inclusive 'procedural multilateralism'". It gave a formal voice to all the United Nations, and to other nations that had remained neutral.

Now, as then, we need international, pluralistic academic and political leadership to foster a new procedural multilateralism. That is the only way to build a global monetary system that can help countries to end this pandemic – and to tackle climate breakdown.

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