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Exorbitant Global Imbalances

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Abstract

The Bretton Woods system in the aftermath of the Second World War provided the world economies with a monetary framework to replace the Gold Standard that prevailed in the preceding period. The system to rebuild war-torn economies worked fine but it could not meed the needs of the growing world trade and economy. Post Bretton Woods world evolved into a global reserve system adopting the currency of the dominant power at this time, the United States, the dollar. In the second half of the 20th century the status of the dollar as the international reserve currency was unchallenged and the United States benefited from this privileged position, for which, although, it had to pay a small price for that as well. In this paper we look at the consequences – mostly economic – this global reserve system in terms of its stability, adjustment mechanism, and its equity.

JEL classification numbers: D63
Keywords: Schwarz's inequality, Triangle inequality

1 Introduction

Valery Giscard d'Estaing in the 1960s, then France's finance minister, summarized the dollar's position as exorbitantly privileged (see (Eichengreen, 2011)). Anything that is exorbitantly privileged cannot sustain its position for a long time as the term implies an unstable structure. So that it was as if d'Estaing was prophesying the coming troubles of the existing system and the dollar as well. The Bretton Woods institutions brought about by the Second World War could not meet the demand of a fast growing world economy, trade, and finance. Although after 1971-3 the system was revised and modified, it essentially stayed the same and the dollar kept its privileged position, whether exorbitantly or not. As the world monetary system hobbled along in the late 70s and 80s, more strains and stresses were building into it as a result of economic and political liberalization and technological revolutions. The forces released by these revolutions converged in 2007-08 to wreak havoc within the system and the world economy had its

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worst economic crisis since the Second World War. Most of the indications are pointing towards certain global imbalances created by the existing system that have caused this global financial crisis[2]. In this paper, I explore the role of the privileged position of the dollar and to what extent it might have caused the balances and hence in an indirect way led to the crisis. I am also looking into the question whether the existing international monetary system and the dollar's position in it is sustainable and if this is not so what kind of system might replace it.

The financial crisis of 2007-08 were built in stages, the beginning of which going back to the East Asian financial crisis if not earlier. Still to understand the current situation better, one should take a broader historical perspective to look at the international economics scene. Since the breakdown of the Bretton Woods system of the global exchange system, which also corresponded to the golden age of the global capitalism, the world went through three main boom and bust phases of international business cycles. In the postwar period right up to the breakdown of the Bretton Woods system, capital controls were in place and countries could follow more or less their independent monetary policies. Yet, economic growth in Western European countries, especially Germany, and Japan let them increase international reserves, i.e., their dollar holdings, as a result of current account surpluses with the United States which drained the U.S. gold reserves and eventually ended the Bretton Woods system fixed exchange rates. With this also came the end of relative stability of world economic environment that led to the postwar reconstruction of war torn economies of the world. After the world oil shocks were over, the Volcker disinflation policy and the U.S. government budget deficits brought about high interest rates which caused the dollar to appreciate and widened the U.S. current account deficit. This was the first phase of increasing global imbalances in the post Bretton Woods system, which the 1985 Plaza Accord tried to manage and unwind in an orderly manner ((Eichengreen, 2008)). Unfortunately, working off the imbalances were not so orderly: Japan went into a long slump, which in its turn prepared the ground for the coming East Asian financial crisis.

The East Asian financial crisis of 1997 was a turning point, in many respects, for the global reserve system. Because at this point East Asian countries such as Indonesia, Thailand, South Korea, as well as later Russia and Brazil, humiliated in the hands of IMF, sought strategies against sudden reversals of capital flows. They and others found a kind of self-insurance by accumulating their international reserves, mostly in the form of the dollars, which led to the increased demand for the dollars and further increased the current account deficit of the United States that was also exacerbated by the strong domestic growth at home. The third phase of the widening current account deficit of the United States came in the aftermath of the dotcom bubble in the United States again as a need for self-insurance of the emerging economies and higher commodity prices.

Here it is important to note the cyclical behavior of the dollar, see Figure 1 as a result of inherent instability of the global reserve system (O'Campo, 2007). The cyclical behavior of the dollar reflects the cyclical demand for it all necessarily stemming from the pro-cyclical behavior of the capital flows. The need for international reserves increased after the East Asian crisis and it has accelerated after the dot com bubble burst as a result of self-insurance desire of the developing countries, which was mostly, indeed, insurance against the free movement of capital that was set free in the 1980s. Ironically, the

[2]See for example (Obstfeld & Rogoff, 2009)

proponents of the flexible exchange rate system defended that in contrast to a fixed exchange rate system, flexible exchange rates decreases the need to accumulate the international reserves because there would be no need to defend the currency against speculators. However, history proved the contrary.

After the East Asian financial crisis and especially after China joined the World Trade Organization most of the emerging market economies started accumulation of global reserves both as a result of self-insurance against pro-cyclical capital flows as well as part of their export-led growth strategies, see Figure 2, The latter especially led to the accumulation of international reserves because the export-led strategy growth required an undervalued currency in order to sell abroad in a fiercely competitive environment.

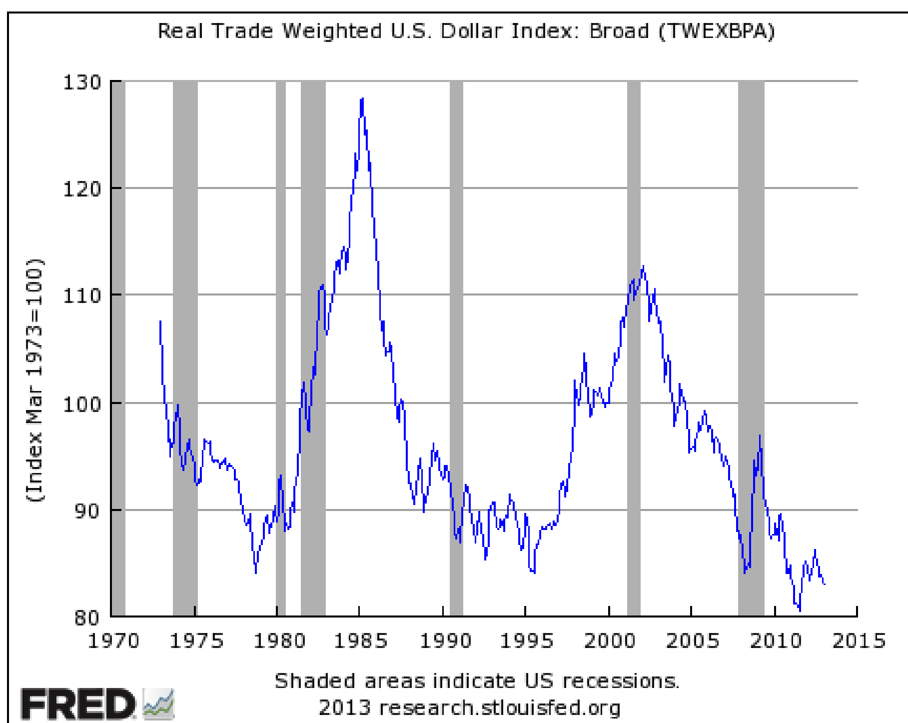

Figure 1: The Story of the Dollar. Source: The Federal Reserve Bank of St. Lois

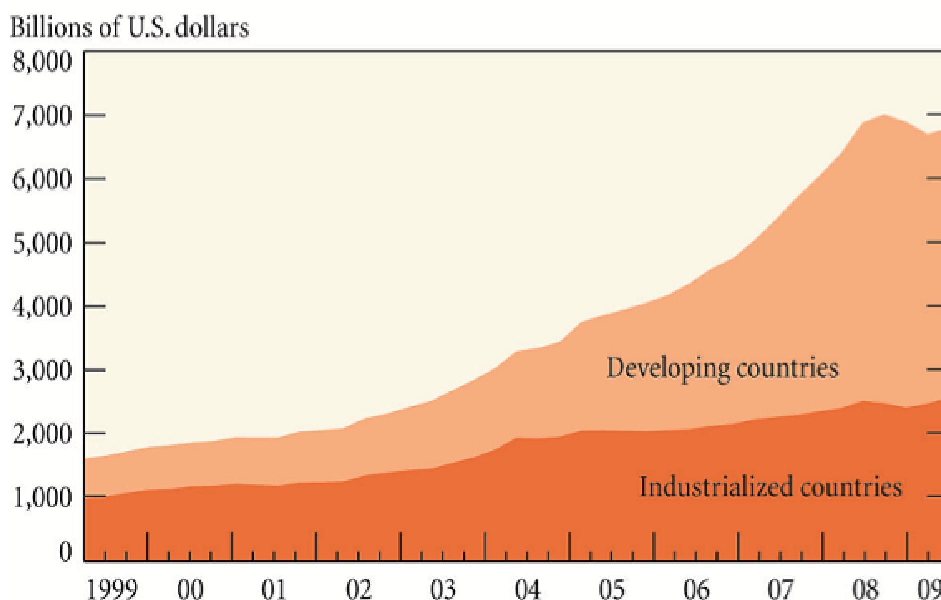

Figure 2: Foreign exchange reserve holdings. Source: International Monetary Fund, Currency Composition of Official Exchange Reserves (CCFER) data.

This paper analyzes the privileged position of the dollar in the international monetary system, which is also called the global reserve system. Section 2 describes the evolution of the international monetary system since the gold standard up to the present system. Section three looks at the functions of international currency and the benefits and responsibilities that come with it. Section four analyzes the global imbalances and instability comes with it as a result of the global reserve system. Section five explores the possibilities of alternatives to the dollar and the standard of the dollar and section 6 concludes.

2 The Global Reserve System

To understand the role of the dollar we should look at in the context of the global reserve system which is the de facto international monetary system and it is an artifact of the Bretton Woods agreement that was reached while a post World War II reality still fresh in the minds of the representatives gathered in Bretton Woods, New Hampshire. Yet, today's world especially after the 1990s reflect very little of this reality that prevailed in the aftermath of the Second World War. As the rise of China and other emerging economies reduce the relative political and economic power of the United States, the privileged position of the dollar as the symbol of this power has been questioned. There has also been pressure to increase the voting rights of the emerging economies in the IMF and the World Bank. The rising power of emerging economies can also be seen as the original G-7 group has been enlarged to G-20 including the BRIC (Brazil, Russia, India, and China).

In this section I would like to look at the evolution of the international monetary system, which is basically a reserve system since its beginning in 1875. In the past and even in the

present monetary systems were mostly determined by the dominant economic and political-military power of the era. In the period between 1875 and 1914, the international monetary system was based on gold and it was called the Gold Standard, which was one of pillars of the globalization that preceded the First World War. It was put in place and defended by internationalists, who were bankers and industrialists in the richer countries and farmers and commodity producers in the poorer countries, around the world who would benefit from the globalization of trade and finance.[3]The gold standard facilitated free trade and international finance by providing a stable flow of payments and exchange. So it is possible to talk of gold as the conduits of a global network through which goods and services flowed. Yet, there was a downside to using the gold standard: the country that went on was practically giving up its monetary policy to smooth out its business cycles. The gold specie mechanism implied that prices, including wages, had to follow the gold stock available in the country so that during the balance of payments deficits price levels would drop sufficiently for the country to increase its exports and reduce its imports in order to balance its trade. It was a good recipe for the international bankers and investors to get paid without any interruption and to get paid profitably.

Free trade, international finance, and the gold standard had their heyday right up the First World War, which disrupted so many things in so many different walks of life (Frieden, 2007). After the Great War the spread of mass democracy hastened and made it much harder to defend the continuation of the gold standard in the face of economic hardships. Britain, with the urge of internationalists, tried to get back on the gold standard in 1926 but in the face of high unemployment and mass demonstrations could not continue for a long time and went off gold in 1931. The global economic crisis of the early 1930s disrupted international trade and led many countries give up the gold standard and then naturally disappearance of the international monetary system turned the global system of trade and finance into autarchy. Before the war, the British pound sterling was the international reserve currency but it was not alone: German mark and French frank were also used as international vehicle or invoice as well as reserve currency. Yet, during the interwar period the dollar caught up with the pound sterling. Before the war, Great Britain was responsible for a third of the world trade and its current account surplus was about five percent of its GDP, mostly consisting of interest and dividend income from its overseas investments. During the war, however, to pay for its war effort it had to liquidate most of its investments. On the other hand, the establishment of the Federal Reserve in the United States in 1913 and the efforts of the internationalist bankers in the United States to promote the dollar into the position of an international currency brought the dollar into prominence and during the interwar years the two currencies, the pound sterling and the dollar, were both used as the reserve currencies although the need for the reserve currencies had been greatly interrupted after the shutdown of international trade in 1933 and during the Second World War.

Because of fixed exchange rates, global price levels moved together as a result of price-specie-flow mechanism which worked through the balance-of-payments adjustment process. For the system to operate efficiently, central banks or monetary institutions supposed to adjust the discount rate, so called the “rules of the game”, see (McKinnon, 2005). Yet the adjustment process mostly fell on the deficit countries instead of the

[3]The adoption of gold standard or going on gold, was not a frictionless process as the populist movement against the gold in the United States in the 1890s attests to that.

surplus countries simply because surplus countries could continue to accumulate gold forever but the deficit countries could not carry balance of payments deficits forever.[4] As (Keynes, 1930) noted, it was not the balance-of-payments adjustment but rather the level of economic activity that had to adjust through the falling prices. Financial prices are flexible and can adjust very fast but wages are rather sticky and will not adjust so quickly leading to lower economic activity and higher unemployment rate. So, adjustment process usually exacted a heavier toll on labor than capital.[5] Over the gold standard period price stability was gained at the cost of higher unemployment but the system was much more unstable over the short run as the balance of payment adjustment process forced countries to adjust faster than otherwise.

Once it became clear that the Allied Forces would win over the Central Powers, winners did not want the chaotic scene on the stage of international trade and finance repeat: they convened a conference about the post war international finance in Bretton Woods, New Hampshire, in 1944. Technically, the Bretton Woods system promoted a fixed exchange system that each participating country fixed the dollar exchange rate of its currency and guaranteed to buy or sell the dollar the at that rate. Only the reserve currency, i.e. the dollar was fixed in terms of gold at $35 per ounce of gold. Given that capital controls were in place, each country could follow an independent monetary policy in order to follow domestic macroeconomic objectives. Yet that was a time when the liberalism of the markets were reigned in and governments tolerated a little bit of inflation in return for a lower unemployment rate. The system could not continue more as the center country, i.e. the United States, had chronic current account deficits leading to the loss of its gold reserves and the loss of confidence in its ability to convert the dollar into gold. At the same time France and other countries voiced their concerns and even they wanted to convert their dollar holdings into gold. This was not something unexpected, on the other hand, exactly something predicted by the Triffin's Dilemma, (Triffin, 1961), which said in a world of growing economies the value of dollar in terms of gold cannot be fixed and the dollar accumulation by the surplus countries has to be balanced by the trade imbalances incurred by the United States. If there was no constraint on the surplus countries accumulating the dollars then there will be no check on the deficit country's external imbalances. Clearly global economic growth required more liquidity, supplied by the center country, that would eventually go back to the issuing country providing it with a very soft constraint in its private or public borrowing requirements the inevitable outcome of which would be inflation in the prices of goods and services or financial assets.

Technically the Bretton Woods system of international financial architecture came to an end in 1971 when the United States shut down its gold window and refused to convert paper dollars into gold. The Bretton Woods system tried to eliminate the strict conformism of the Gold Standard by replacing it with a little more flexible system of fixed exchange rates with the dollar. In this sense imbalances could be tolerated a little longer, only bound with the tolerance limits of the surplus countries with the deficit

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[4]This asymmetry in the adjustment process today is still valid today: adjustment is mostly the responsibility of the deficit country instead of the surplus country. A better designed system should equally distribute the responsibility.

[5]Perhaps that was the reason why Britain preferred to act according to the rules of the game but France was rather reluctant to do that.

countries which were not too high any way because no capital flows were allowed hence no borrowing from the future. The new system that replaced it aimed to make the adjustment process a little faster by allowing exchange rates to float against each other freely and it also tried to make imbalances more tolerable by setting capital flows free. It is important to note that reforming the international monetary system in this direction means less intervention and more market friendly approach, which also very well reflects the post Keynesian view of economy. Yet, the post Bretton Woods system could not exactly envisage what freeing capital flows really meant, however, soon countries that were accustomed following their independent monetary policy in a world of fixed exchange rates and restricted capital flows soon realized that they don't have the luxury of setting their own monetary policy. Now the capital was free to pursue the highest return regardless of where it is. The era of national capitalism was over.
The post Bretton Woods system could not envisage the consequences of free capital flows, especially to what extent it would tolerate global imbalances. Although, flexible exchange rates was one way for the adjustment process to operate, pursuit of industrialization by many developing countries following an export-led growth strategy complemented by free capital flows tolerated global imbalances much more than during the Bretton Woods period. To continue the system, the surplus countries keep accumulating their international reserves mostly in dollars, which looked more and more like getting entrapped in a Ponzi pyramid.

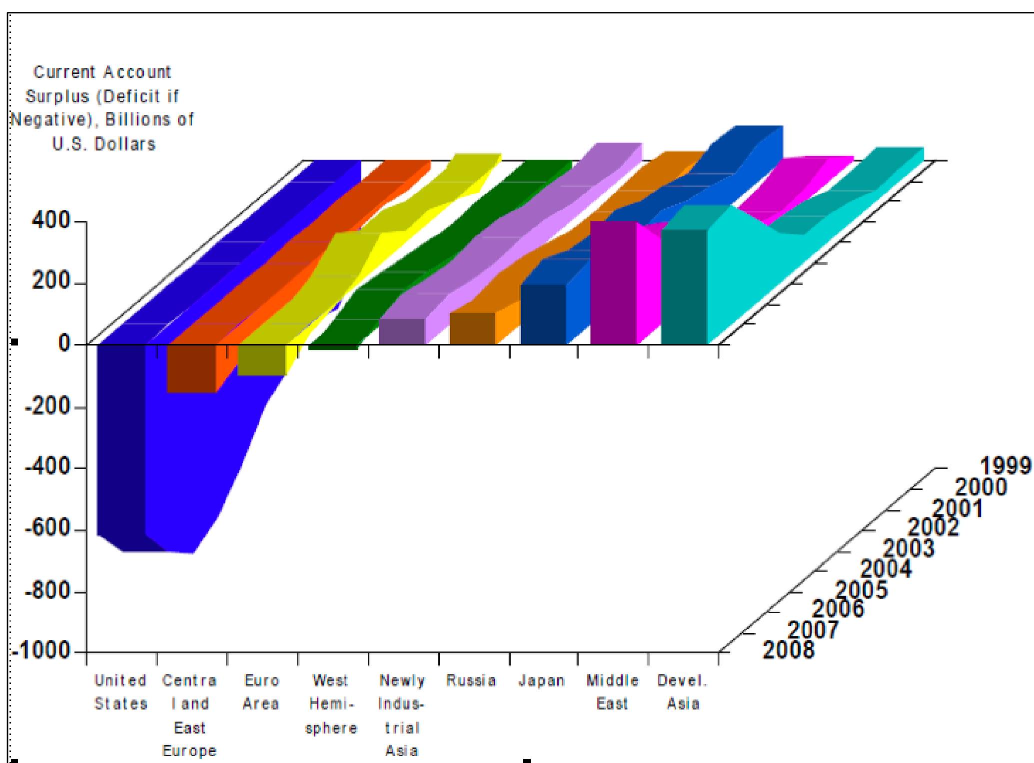

Figure 3: Global imbalances, (Obstfeld, 2012) based on (Lane & Milesi-Ferretti, 2007) data.

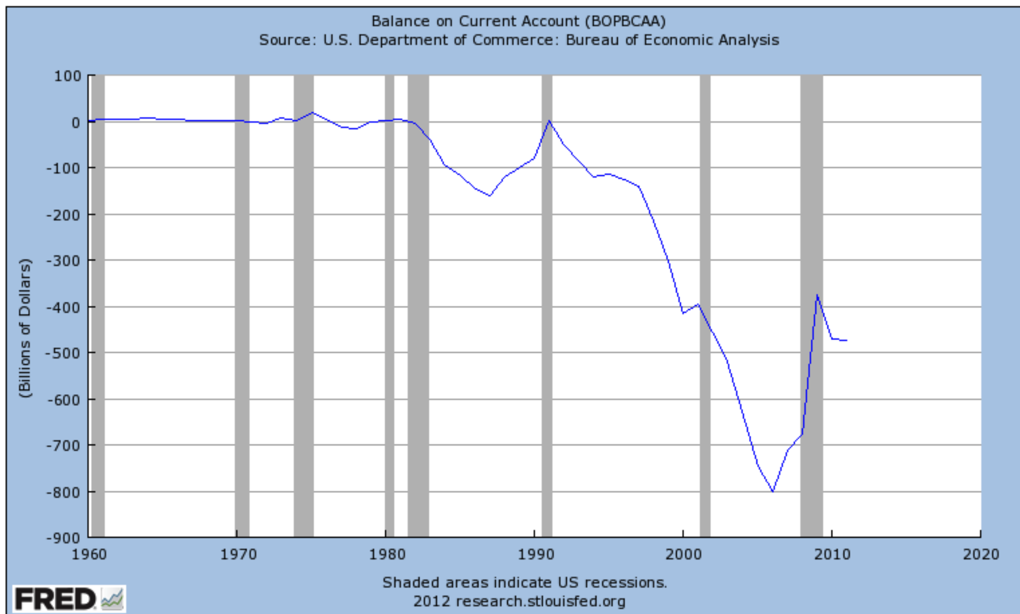

Figure 4: The U.S. Current account deficit

3 Global Reserve Currency

In this section I would like to look into the relationship between the dollar and the global imbalances. It is more of a question that why indeed the United States has such a big current account deficit with the rest of the world, especially with the developing countries as in Figure 3.[6] In the same figure the Middle East has a big current account as a result of high oil prices and exports. The U.S. trade deficit with the rest of the world has been big and growing over the years, see Figure 4. It is hard to explain this imbalance by appealing to profitable investment opportunities in the United States, or overvalued currency, or high import demand as a result of fast economic growth. Since 1980 the United States has had chronic trade deficit with the rest of the world waning and waxing with the domestic and global business cycles but getting worse over time pointing to some structural issues. The origin of these issues cannot be only home born because America can only continue to incur its current account deficit, i.e. continue to borrow from the rest of the world, as long as the rest of the world are willing to tolerate it. Then the question is why the rest of the world, especially emerging economies of Asia, wanted to lend to America.

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[6]Not all emerging economies, of course, has a surplus with the United States. For a chronic trade deficit problem of Turkey see (Dalgin & Gupta, 2012).

Function of money	Governments	Private actors
Store of value	International reserves	Currency substitution (private dollarization)
Medium of exchange	Vehicle currency for foreign exchange intervention	Invoicing trade and financial transactions
Unit of account	Anchor for pegging local currency	Denominating trade and financial transactions

Figure 5: The Role of reserve currency

Lending to the United States in this regard means that they wanted dollars in return for their exports to the United or other countries. But, eventually exports had to somehow end up in the United States which is the sole country that can issue these dollars leading to continuous trade deficits as it is studied in (Dalgin, 2013). So the demand for the dollar as an international currency comes from the various functions of it. Like any other form of money, an international currency fulfills three functions, which are store of value, medium of exchange, and a unit of account, see Figure 5. The dollar as an international currency fulfills many different functions such as a reserve currency, invoicing currency, vehicle currency, transaction currency, etc., that broadly falls into these categories. There is a natural difference between a national currency and international currency. A national currency is a fiat money declared by the government which also accepts it as tax payments. Yet, the validity of an international currency is mostly decided by the international markets usually emphasizing the medium of exchange and the unit of account role of money than the store of value role of money.[7]

There are several reasons necessary for a currency to be used internationally such as country's the share of world trade, depth and liquidity of its financial markets (Tavlas, 1998). There are also network effects that give an economies of scale dimension to the use of one currency turning it into a natural monopoly. Moreover, various benefits accrue to the country whose currency becomes an international one such as seigniorage, issuing debt in its own currency at low interest rates. Also possibly its finance industry thrives at the expense of its tradables sector such as manufacturing, which is burdened by the overvalued currency. Besides, the country might be less vulnerable to exchange rate fluctuations and capital flow reversals the current account deficit might be a problem in the long run which might lead to worsening net international investment position. Having said that, we must observe that the United States must have benefited handsomely overall as most of the commodities, including oil, in the world are quoted in dollars creating a big demand and network effects for the dollar in some sense creating a "dollar hegemony", see (Liu, 2002). The table given in Figure 6 provides information about the extent the dollar is being used.

[7]There is a useful distinction between the two; the former approach emphasizing the role of government corresponds to the chartalist view of money and the one that is emphasizing the role of markets corresponds to the metallic view of money, see (Goodhart, 1998).

Arrangement	Number of Countries 1995	2000	2005	2007
Dollarized or formed currency board	9	8	7	7
Pegged exchange rate regime against dollar	82	85	90	89
Maintained managed floats with dollar as reference currency	6	8	6	8
Total reporting	207	207	207	207
Memo:				
Currency linked to dollar (percent)	47	49	50	50
Gross domestic product linked to dollar (percent)	21	29	31	36

Figure 6: International reserves. Source: (Goldberg & Tille, 2008)

Since the end of the Bretton Woods fixed exchange rate system the dollar has been following a downward trend against the other major currencies of the world. The dramatic increases in the early 1980s and in the second of the 1990s are usually rather seen as deviations from this downward trend.

3.1 A Multipolar Monetary System

In this section I would like to explore possibilities other candidates as international currency. First of all for a currency to be an international currency it has to have low transaction costs, i.e., the difference between ask and bid price, and the markets where the currency traded have to be liquid. Both of which conditions are not necessarily independent but rather cross reinforcing. There are various candidates for this such as British pound or Swiss franc. British pound used to be the international currency prior to the World War I but in the post World War II period the dollar replaced it. Right now the British economy is not big enough to provide the necessary depth of liquid markets nor its government debt is enough to provide the necessary instruments to keep the currency locked in when it is not needed for transactional purposes. We can say the same for the Swiss franc. One might also consider the Japanese yen as a suitable currency because comparatively the Japanese economy is relatively much larger than the British economy; however, any international role for the Japanese yen has been discouraged by Japan deliberately as it might have intervened with its industrial policy in the 1980s. After that it looks as if there are only two natural candidates for the international currency position: Chinese Renminbi and the Euro.

The GDP of the Euro area is similar to the US GDP and the government debt issued by the Euro area countries. However, the debt issued by various European governments are not uniform in terms of their risk assessments and in terms of liquidity. German government bonds are regarded as a very safe asset but they are not traded very frequently and usually held to their maturity. Although, the Italian government has a big debt but they are viewed riskier. Enlargement of the Euro area could have increased the chances of

the euro such as the Scandinavian countries joining the Euro area but it does not look like this will be happening any time soon. Also, if the British opted to be in it would be a quite different story because of London as a financial center would increase the euro shares in financial transactions and hence increase its liquidity by increasing its demand and supply.

One of the most important issues about the euro being an international reserve currency is whether there can be a medium of exchange without a proper governmental authority to back it up. As the most recent global financial crisis has proved that solely monetary policy without a fiscal policy complementing it is not enough to inspire confidence in the currency. Also, according to the research by (Goodhart, 1998) just markets are not enough to sustain a medium of exchange in any form. Histories of the Roman Empire or the Shogunate Japan in the thirteenth centuries have shown that there has to be a central governmental authority issuing the currency and demanding to be paid in it. The euro lacks any kind of monetary and fiscal policy coordination. In addition to that, unfavorable demographics and expected slower economic growth are not helping the euro become an international reserve currency.

However, it is possible to talk of a Euro area, where the euro is used as an international currency in the countries that are at the periphery of the European Union. Russia is a case in point. It has recently announced that it would convert some of its international reserves that it is holding in dollars into the euros. Russia is at the periphery of European Union and most of its trade is with the European Union, hence it should make sense for Russia and other peripheral countries to use the euro as their reserve currency or vehicle currency as well as their transactional currency.

Even though the European Union never shown much enthusiasm for the euro to become an international currency, China wants its currency, Renminbi, to be reserve currency by 2020 and in a series of attempts and agreements has proved its willingness to make the Renminbi an international currency.

4 Global Imbalances

So far I have been looking at the evolution of the international monetary system and the special role of the dollar in it. How should we judge whether it has been successful or not? Yet, we need to remember that systems are not set up in a vacuum but in an environment, which itself evolve over time under the influence of technological developments, mood of people, geographical effects. Even a good system may not stay good for a very long time unless it is reformed. One might think that a good system is the one that is flexible and reformable when needed. Given that, we might think of a system as successful if it is stable, equitable, and inspires confidence in the people who participate in it.

In terms of stability the Bretton Woods system worked really well compared to post Bretton Woods financial crisis. There were no major financial crises and growth rate proved quite satisfactory. But, that was the time when governments could follow independent monetary policies without worrying about capital flows. Although fast export-led economic growth in Japan and Germany caused a drain on the gold stock of the United States, this was managed by revaluing the exchange rates of the German Mark and Japanese Yen against the dollar. Yet the stability of the system has proved a big problem in the Post Bretton Woods world starting with the Latin American debt crisis in the 1980s and then East Asian financial crisis later spread to Russia, Brazil, Argentina,

and then Turkey. Then finally came the biggest crisis of all that involved the advanced economies in 2007-08 as well as emerging market economies.

In this section I would like to look into the causes of the imbalances, such as stability in terms of the adjustment process, capital flows, the demand for the international currency. A system's stability bears on the efficiency of its adjustment process. (Keynes, 1930) was critical of the Gold Standard, or for that matter the fixed exchange rates regime, because he claimed that on two grounds the system fails to be fast and efficient. First of all, the Gold Standard presupposed that trade imbalances would be speedily corrected by internal adjustment of prices including wages, which are known to be not as flexible as financial prices. Hence, this adjustment will mostly fall on the labor and the adjustment will be achieved by a decrease in output at the cost of full employment. Indeed during the Golden Years of capitalism unemployment rate was much lower than the unemployment after these Golden Years, basically after 1975.

But also adjustment process was impeded by the actions of surplus countries which started to accumulate reserves as a self protection against the volatility of global capital flows leading to global imbalances in trade and the US being designated as the consumer of last resort as can be seen in Figure 3.[8] This issue is very much in line as foreseen by Triffin in the late 1950s and early 1960s (Triffin, 1961). In terms of equitability of the system, it is also wanting as it was the developing countries that were bearing most of the burden, it was the emerging markets in the 1990s, and then advanced countries in the late 2000s. The division looks equitable but really it was mostly labor beyond capital owners and lenders that were bearing the burden of a financial crisis simply because the financial crises had become crises of financial flows, which we should turn now examining their role bringing about the crisis.

4.1 The Role Capital Flows in Creating the Imbalances

International capital flows are supposed to allocate surplus savings to their most productive uses across the world in order to obtain the highest return and confer the most benefits to the owners and users of them. In this respect, international capital flows enhances world welfare and should be a beneficial cause to defend. Yet, capital flows pose challenges, which are macroeconomic adjustments and financial stability, to the world economy in general and individual countries in particular to deal with. In terms of macroeconomic adjustments we can think of internal deflation, including wages, when there is a trade deficit so that exports will become more competitive. Financial stability is very much related to the efficiency of the financial markets in case of a big surge in capital flows how efficiently the flow of the funds are allocated to their most efficient uses (Bernanke, 2011).

Plausibly, the logic of capital requires that capital should flow from capital rich countries to capital poor countries where it might be put into use more profitably. However, the logic has been turned upside down before the last financial crisis as the United States was receiving 6% of its GDP as incoming capital flows. So it is not always in the interest of the capital that it is seeking the highest return sometimes it might just be seeking safe assets or capital might flow as a result of exchange rate policies of emerging economies in order to protect their exchange rates to promote the export-led economic growth policies

[8]For further details see (Dalgin, 2013)

as we have already indicated these cases above. Overall, without the international capital flows international trade would look like international barter where nations would only trade goods and services; whereas capital flows provide them with the opportunity to trade intertemporally by buying and selling assets. This is a challenging problem for the world economy as the economies are coupled and correlation among them increases contagion effects will be much more severe.

5 Conclusion

In this paper I have tried to explore the role of the existing international monetary system, whose present instantiation is the global reserve system with the dollar being the world currency as well as the impact of the capital flows in creating the global imbalances. I have looked at its performance since the Bretton Woods system in terms of stability, adjustment, and equity and found the system wanting in these characteristics. A better system should address the stability issue first and foremost paying attention to equity and fairness. In a stable system, adjustments would not be so drastic and frequent.

Compared to the Bretton Woods system, post 1975 world is quite a volatile world as the liberalization of the capital account in many countries and the technological developments increased the speed and volume of capital flows. Developing economy banking crises in the early 1980s, emerging market crises in 1990s such Turkey, Mexico, and the East Asian economies, and later technology and real estate bubbles in the 2000s show the volatility and instability caused by the capital flows. Even though, capital has reasons to flows as a result of push and pull factors, restricting their free flows should help to stabilize economies without hindering economic growth in the emerging markets as most of these capital flows consist in financing credit or consumption bubbles which has nothing to do with economic growth if not inversely affecting it. Of course, capital flows is a sign of more integrated and globalized world economy coupling world economies together and increasing the correlation between them. Perhaps, to some extent it speeded up the end of the cold war, one of the biggest impediments in front of globalization. Before the 1970s the soviet economy and its satellite economies were doing fine in their isolated world. Yet, after the Soviet economy was drawn into the world markets through agricultural products, especially wheat, as well as oil prices, it started to feel the volatility of market on its own economy. This did probably contributed to the process of breaking up the Soviet Empire.

The adjustment mechanism of the system is far from being smooth and minimum cost. First of all it is a prutanic system that finds fault mostly with the profligate deficit countries and puts the responsibility of adjustment on their shoulders. In the existing system, trade deficits cannot go on forever, yet surplus countries do not have any external constraints to reduce their surpluses. The current global reserve system made possible for several developing-emerging market economies to follow export-led growth strategies accumulating the global reserve currency and at the same let the United States sustain its trade deficit with these recycled reserve dollars. In some ways, the system could delay the adjustment as long as possible with the higher adjustment costs the longer the delay. A better adjustment system should comprehensively include all the trading partners.

The equity or rather the lack of the equity in so many different ways in the present system is conspicuous. The increase in world inequality has been following a similar trend as the globalization and integration of the global markets. The long-drawn and ever growing

imbalances led to increases in inequalities and helped them to be sustained for a long time. The adjustment costs fall more heavily on labor in terms of both lower wages and less than full-employment. Moreover, the American dream for a while has been sustained through a real estate bubble and lower consumer prices even though productivity gains were not passed on as higher real wages. The world at this stage should consider the existing economic system in general and the monetary system in particular as well as the ideology of the free markets, free trade, and international capitalism facilitated by the international reserve system. The goal should not be maximum consumption built on maximum trade and capital flows but rather an unalienated "good life". Capitalism, first national and then international grew out of feudalism, used the available structures of the pre-capitalist systems and thrived on them – in a sense these structures were used up in the process of production similar to natural resources used up in the production. Unfortunately, once these resources are gone and the social texture is very much depreciated, there is not much else for the capitalism to thrive on except to grind up its own structures and damage the environment in so many different contexts. The 2007-08 crisis provides us with a good opportunity to review the process and reform the system.

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