The International Financial Architecture

Reform and Continuity

Alfredo Hernandez Sanchez

VU TSPMI

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Initial Questions

- What is Money?
- Why were the Bretton Woods institutions created?
  - Political factors
  - Economic economic
  - Ideological factors

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The Bretton Woods Institutions

Historical Background

- 1929 Stock Market Crash: banks overextended themselves by lending for stock market investments. As the market crashed, banks failed, leading to loss of savings.
- Mass unemployment (25% in 1933 in USA): High tariffs (like the Smoot-Hawley Tariff in 1930) reduced global trade, worsening economic conditions.
- Dust Bowl: over-plowing and poor land management in the US destroyed native grasses that anchored the soil, drought during the 1930s turned the exposed soil into dust.
- New Deal: significant shift in the U.S. government's role in the economy, emphasizing social welfare and greater state intervention which included several financial reforms:
  - Glass-Steagall Act separated commercial and investment banking to reduce risk in the financial system
  - Securities and Exchange Commission (SEC) regulated the stock market and prevented abuses.

Articles of Agreement of the IMF

The contemporary international financial system traces its origins to the Bretton Woods system (1944) and the creation of institutions like the IMF and World Bank. The USD was backed by gold reserves at $35 per ounce, all other major currencies were pegged to the USD.

- Article 4(5f) notes that the IMF "shall not object to a proposed change because of the domestic social or political policies of the member proposing the change [in exchange rate]". (Helleiner 2022)

Embedded Liberalism

- Countries could pursue liberal international trade while protecting their domestic economies from the social and economic dislocations that could arise from global market forces.
- During this period, countries chose monetary policy autonomy (to manage domestic economies) and exchange rate stability (via the Bretton Woods system).
- Capital mobility was somewhat restricted, allowing governments to maintain control over their economies without destabilizing foreign capital flows.

Trilemma

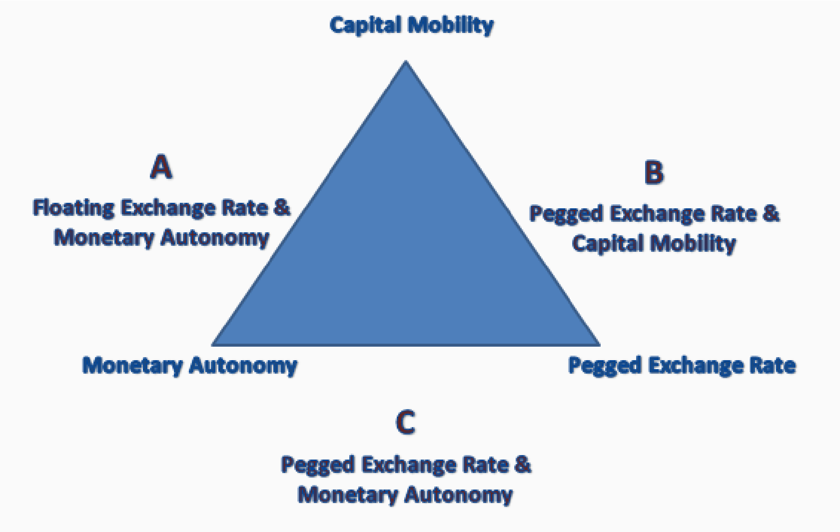

Figure 1: The Macroeconomic Policy Trilemma; Source: Brookings Institute

Import Substitution Industrialization

- Protectionism: High tariffs and trade barriers to protect emerging domestic industries from foreign competition.
- State Intervention: Governments played a key role in directing economic activities, providing subsidies, and managing key sectors.
- Domestic Market Focus: Industries were oriented towards serving the domestic market rather than export markets.
- Nationalization: In some cases, the state took control of key industries to ensure their growth and stability.

US Economic Imbalances

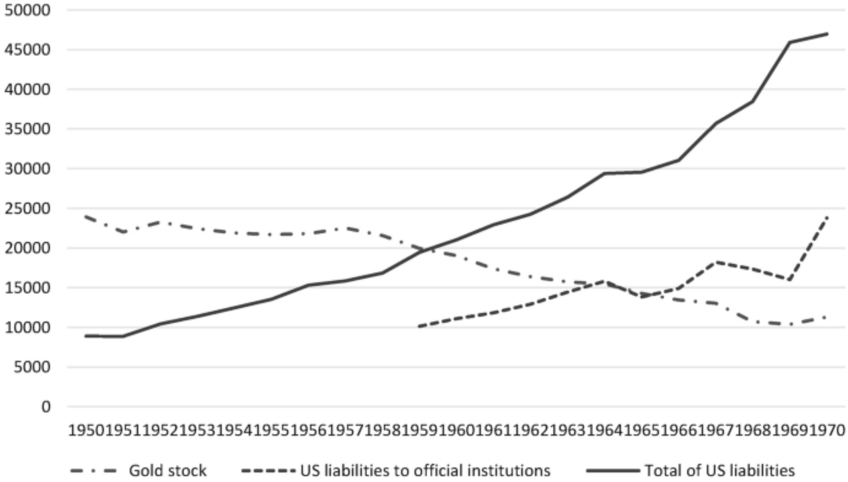

Figure 2: US Gold Holdings and Liabilities; Source: (Pittaluga and Seghezza 2021)

1973 OPEC Oil Embargo

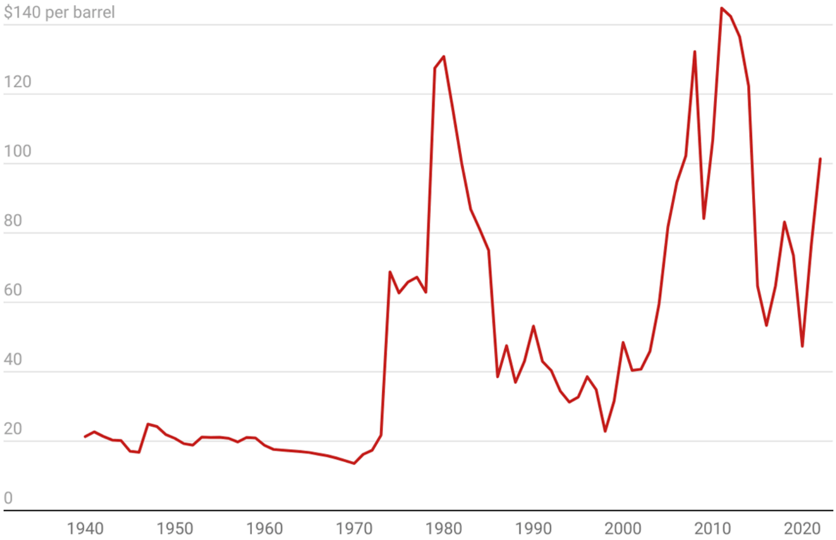

Figure 3: Inflation adjusted price of oil per barrel; Source: Energy Institute Statistical Review of

The Nixon Shock

- By the 1960s, too many USD were circulating to maintain the convertibility into gold. On august 15th, 1971, President Richard Nixon closed the dollar window and the contemporary fiat monetary system was born.
- Factors that led to the end of convertibility:
  - The U.S. was running large trade deficits, meaning it was importing more than it was exporting.
  - High inflation, partly due to the Vietnam War and increased domestic spending, which led to more dollars in circulation.
  - Countries holding dollars were losing confidence in the U.S.'s ability to maintain the gold standard, leading them to demand gold in exchange for their dollars, further depleting U.S. reserves.

Historical Interest Rates

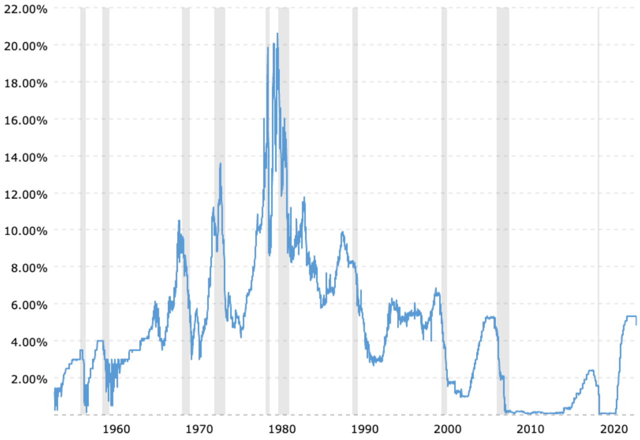

Figure 4: US Federal Funds Rate; Source: Macrotrends

1980s Debt Crises

- The 1973 and 1979 oil price shocks increased global inflation, leading countries to borrow more to cover higher import costs, especially for energy.
- In the early 1980s, to control inflation, the U.S. Federal Reserve raised interest rates sharply. This made debt repayments much more expensive for debtor nations because many loans were contracted at variable interest rates.
- Many developing economies relied on commodity exports (e.g., oil, copper, and agricultural products). Declining global prices reduced their export revenues, devalued their currencies, making it harder to service debt.
- In 1982, Mexico announced it could no longer meet its debt paymensts, and led to a generalized loss of confidence in financial markets. The IMF played a central role in managing the crisis by providing financial assistance and helping restructure debts, but with conditions attached.

Washington “Consensus”

1. Fiscal Discipline
2. Tax Reform
3. Redirect Public Spending
4. Liberalized Interest Rates
5. Free Exchange Rates

1. Trade Liberalization
2. Financial Liberalization (FDI)
3. Privatization
4. Derregulation (Competition)
5. Protect Property Rights

Slowballization?

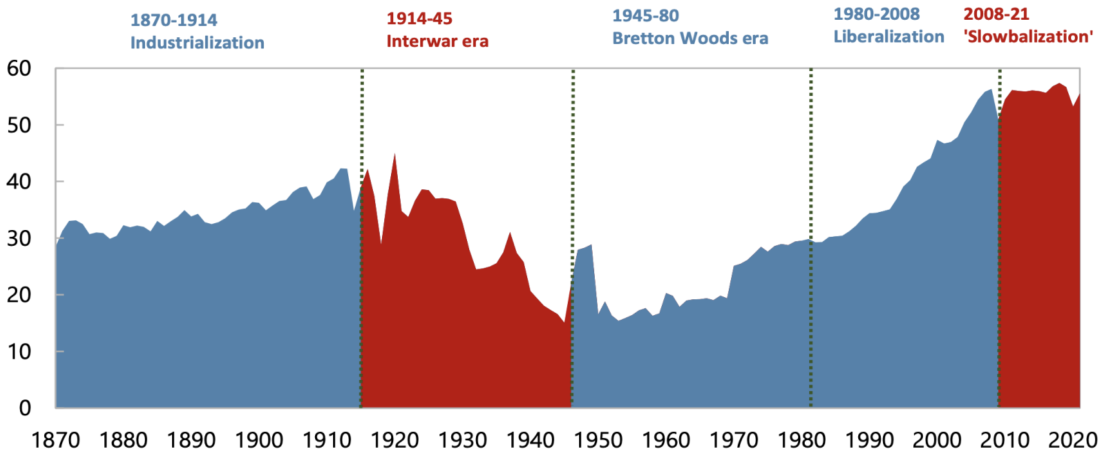

Figure 5: Stages of Globalization

The 2008 Global Financial Crisis

- U.S. housing market and the subsequent failure of financial institutions heavily exposed to risky mortgage-backed securities.
- The IMF provided emergency financial assistance to countries severely affected by the crisis.
- New recommendations included:
  - fiscal stimulus (government spending and tax cuts) to boost demand and counter the global recession
  - low-interest rates and quantitative easing (printing money) by central banks to stimulate economies
  - stronger financial regulation and oversight, urging countries to reform their banking systems to prevent future crises

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Case Study: China and IMF Reform

Lending to the Developing World

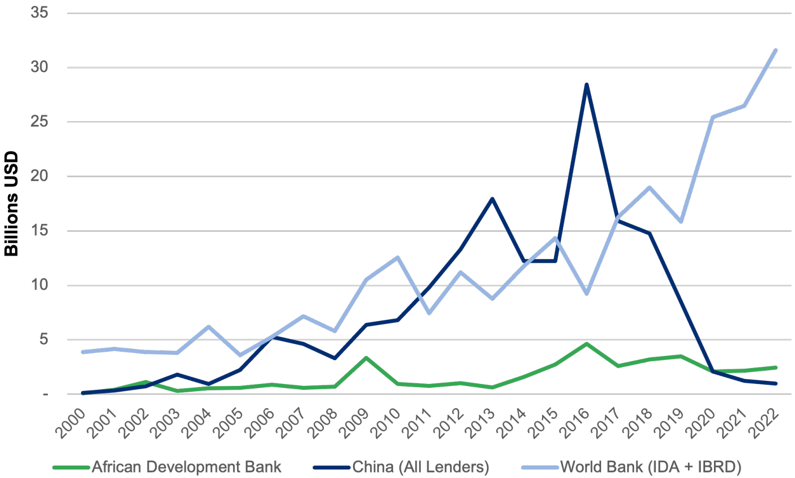

Figure 6: Lending to the developing world in USD billions. Source: Boston University.

Mao and Nixon

Figure 7: Source: Richard Nixon Library, Identifier: 194759

Nixon on China

"My background is not so well known. I also came from a very poor family, and to the top of a very great nation. History has brought us together. The question is whether we, with different philosophies, but both with feet on the ground, and having come from the people, can make a breakthrough that will serve not just China and America, but the whole world in the years ahead. And that is why we are here."

- Source: Wilson Center Digital Archive

Economic Liberalization in China

- 1978: "Reform and Opening Up" policy under Deng Xiaoping. Key reforms include the Household Responsibility System in agriculture, allowing farmers to sell surplus produce in local markets.
- 1984: The opening of 14 coastal cities to foreign investment, expanding the SEZ model to more areas and boosting economic growth through increased foreign trade and investment.
- 1993: Comprehensive market reforms including developing a financial system with a distinction between policy banks and commercial banks.
- 2001: China joins the World Trade Organization (WTO), integrating further into the global economy and committing to lower tariffs and trade barriers.

Critical Juncture: The 2008 Crisis

- The 2008 global financial crisis led to a sharp decline in demand for Chinese exports, significantly impacting China's export-driven economy.
- China launched a massive $586 billion stimulus package focused on infrastructure projects, aiming to sustain economic growth and employment. This investment helped mitigate the immediate effects of the crisis but also led to concerns about overcapacity and inefficient investments.
- The US Federal Reserve's Quantitative Easing (QE) program resulted in increased global liquidity, leading to rapid capital inflows into China. This influx of capital contributed to asset bubbles, particularly in real estate.
- QE led to a weaker US dollar, putting upward pressure on the Chinese yuan. To maintain export competitiveness, China intervened in the foreign exchange market, accumulating large foreign exchange reserves and contributing to global imbalances (Tian 2024; Hudson 2010).

A Bigger Slice of the Pie

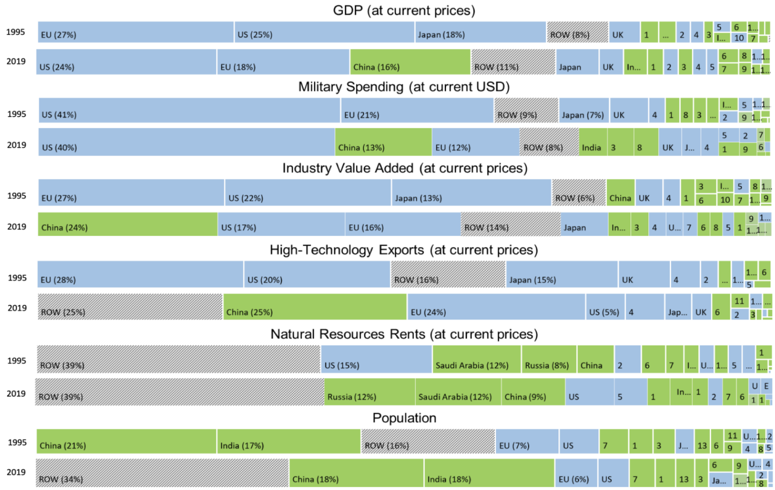

Figure 8: China's economic rise in key areas. Source: Boston University

Brief Overview

- 2012: Xi Jinping becomes the General Secretary of the Chinese Communist Party, initiating a new era of economic policy.
- 2013: Belt and Road Initiative (BRI) is launched to enhance global trade routes and infrastructure investment, aiming to increase China's economic influence globally and address domestic overcapacity.
- 2015: Made in China 2025 initiative is launched, meant to upgrade the manufacturing capabilities of Chinese industries and reduce dependency on foreign technology by promoting innovation
- 2016: The Chinese renminbi (RMB) was officially added to the International Monetary Fund's (IMF) Special Drawing Rights (SDR). China's voting share at the IMF increased from approximately 3.8% to 6.08% of the total voting power, making it the third largest member in terms of voting power, behind the United States (16.50%) and Japan (6.14%). Major policy changes which typically require an 85% majority.

The Belt and Road Initiative

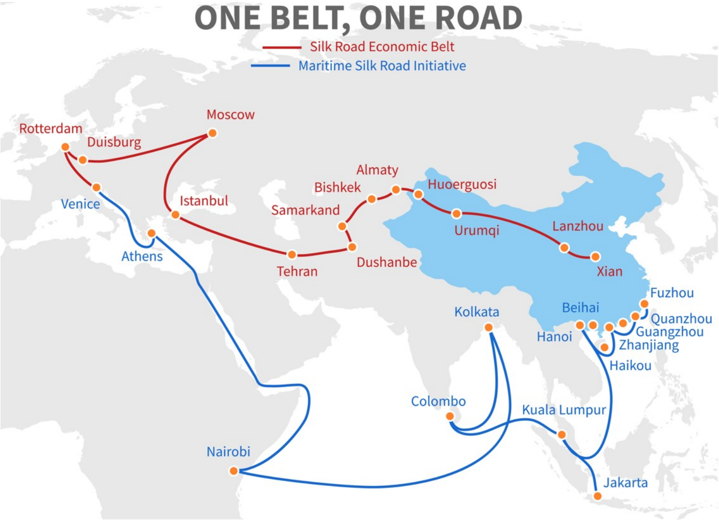

Figure 9: Source: Insight Turkey

Pence on China

"China wants nothing less than to push the United States of America from the Western Pacific and attempt to prevent us from coming to the aid of our allies."

"China uses so-called "debt diplomacy" to expand its influence. Today, that country is offering hundreds of billions of dollars in infrastructure loans to governments from Asia to Africa to Europe and even Latin America. Yet the terms of those loans are opaque at best, and the benefits invariably flow overwhelmingly to Beijing."

- Vice President Mike Pence on the Administration's Policy Toward China

The US-China Trade War

- 2017: Trump assumes the presidency of the US, calls for a review of US trade deficits and the enforcement of tariffs, and initiates an investigation into Chinese intellectual property theft and technology transfer practices.
- 2018: The US imposes tariffs on solar panels (30%) and washing machines (20%), and 25% on steel and 10% on aluminum imports. China retaliates with tariffs on 128 US products worth $3 billion.
- 2019: China begins collecting tariffs on $60 billion worth of US goods. The US announces 10% tariffs on an additional $300 billion of Chinese goods.
- 2020: A first phase of a trade deal is signed, with China agreeing to purchase an additional $200 billion worth of US goods over two years and implementing structural reforms in intellectual property and technology transfer.

The West's Financial Response

Year	Actors	Initiative (claimed financial commitment)
May 2015	Japan, World Bank, Asian Development Bank	Quality Infrastructure Investment Partnership (US$110bn by 2020)
October 2018	USA	Legislation for International Development Finance Corporation; launched January 2020 (US$60bn)
July 2019	Australia	Infrastructure Financing Facility for the Pacific (US$1.4bn)
July 2019	G20	Principles for Quality Infrastructure Investment (n/a)
November 2019	USA, Japan, Australia	Blue Dot Network to implement G20 Principles (existing funds)
June 2021	G7	Build Back Better World (B3W) subsumes Blue Dot Network ('hundreds of billions' of US dollars)
November 2021	UK	CDC relaunched as British International Investment ('part of wider plans to mobilise up to' US$38.4bn by 2025)
December 2021	European Union	Global Gateway Initiative (up to US$305bn by 2027)
June 2022	G7	Partnership for Global Infrastructure Investment (PGII; US$600bn by 2027)

Figure 10: Traditional donors' infrastructure announcements. Source: (Hameiri and Jones 2023)

Stepping on the Breaks?

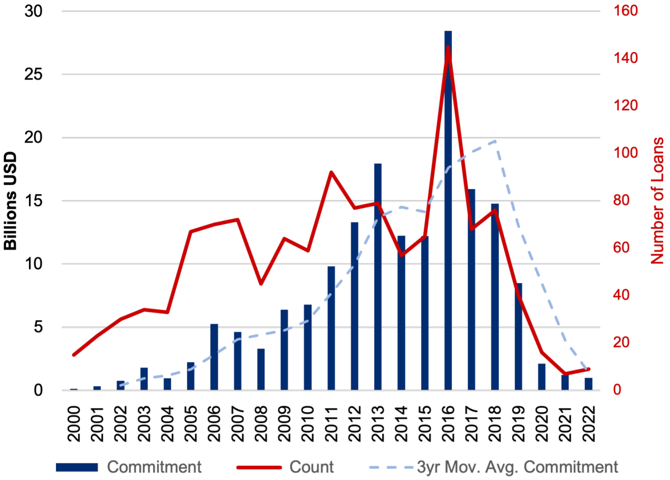

Figure 11: China's loans to the world by volume and number. Source: Boston University

Conclusion

Concluding Questions

- So, what is Money?
- Is the IMF still relevant? The World Bank?

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