Deficit Spending and International Currency Governance. From the Structural Reforms of the Washington Consensus to Currency Multipolarity (1989-2022)

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The Washington Consensus represented the financial rationale of the phase of the globalisation going from the late 1980s until the crisis of 2008, a date which marked the beginning of increasingly fierce criticism concerning its theoretical basis. In some ways, the Washington Consensus represents the culmination of a transformation in economic thinking that began with the electoral success achieved by Margaret Thatcher in the UK and by Ronald Reagan in the US.Here, we are talking about a new paradigm that intends to rethink the interventionist economic policies inspired by Keynesian theory, which had been the point of reference for Western governments at least until the crisis of the 1970s, and - considering monetary policies- until Paul Volcker's appointment as Federal Reserve Chairman in 1975. The use of systematic expansionary fiscal policies was the way through which an essentially rigid production model like the Fordist one could achieve the adjustments it needed. Keynesian economic policies allowed for large-scale economy to be ensure the profitsto repay the large investments needed for the plants at the time. The internal contradictions of the Fordist-Keynesian model became apparent when increasingly inflationary economic policies were used to finance welfare state expenditures without increasing the tax burden. Moreover, such a theoretical approach envisioned that aggregate demand would be financed by the proceeds of sustained and continuous development - which did not even include technological shifts. However, some problems emerged when growth came to a standstill and impacted both the dynamics of social expenditures and the welfare state. The crisis of the Fordist-Keynesian model had significant consequences in developing countries as well. Social protection mechanisms represented too high a cost for the developing countries that were unable to adapt their macroeconomic policies to the oil shocks that led to the debt crises of the 1980s.In the climate of a general rethinking of what was termed the Keynesian Consensus, a general belief in the role assigned to markets, private incentives and micro-founded macroeconomic policies aimed at price system stability came to the fore. Such a set of neo-classical indications were formalised by the economist John Williamson who - in 1989 - drew up a list of 10 directives that intended to be a recipe for developing countries facing an economic crisis[1]. Williamson called Washington Consensus such directives, as they responded to the directions of the International Monetary Fund and of the World Bank, both based in the US capital city. Although the theoretical basis for the Washington Consensus was clear, it featured incomplete and unclear set of instructions overall. For instance, when privatisation was called for, it was not made clear how it should be carried out. Moreover, although none of the ten principles drawn up by Williamson explicitly called for openness to the financial markets, such principles were applied unilaterally and dogmatically, which led to the completion of financial globalisation by favouring openness to capital flows. Despite the theoretical premises, the main feature of the increasing interconnectedness and interdependence of the financial markets was the instability of the system.As a matter of fact, starting from the 1994/95 Mexican and from the one in Argentina during the1995/96 period, a financial crisis a year was recorded until 2002. The Asian financial crisis which occurred between 1997 and 1998 affected Thailand, Indonesia, Malaysia and South Korea. The Russian financial crisis and the subsequent collapse of the rouble in 1998 made its negative effects felt until 2001, infecting the economies of Brazil, Romania, Ecuador and Argentina, in that order. In the 2000/2002 period, it was the turn of Turkey and Uruguay. This series of crises was the consequence of the logic that saw the liberalisation of capital markets - which, as we have seen, was not explicit in Williamson's list - as the main tool to foster economic growth. In order to gain the confidence of the international capital markets, fierce competition arose among the developing countries to attract the financial flows to be used to refinancing their debt. The price that had to be paid in order to win the confidence of the markets consisted of the structural reforms required by the Washington Consensus, which at the macroeconomic level aimed at debt reduction and the stability of the price system through what the Swedish economist Lars Svensson termed inflation targeting, i.e., the achievement of an affordable medium-term inflation target, made clear by the government and numerically quantifiable in its own right. With regard to monetary policy, the formal commitment of developing country governments to set a nominal exchange rate was encouraged guaranteed by currency boards, fixed exchange rate regimes and the renunciation of competitive policies based on currency devaluation.

[1] J. Williamson, *The Political economy of policy reform*, Institute for International Economics, Washington DC, 1994.

The Asian financial crisis was an initial moment of criticism of the Washington Consensus principles, which in the case of the aforementioned countries had an effect opposite to the one predicted by the monetarist theory. The opening to international capital flows gave impetus to an overall appreciation of the Asian countries' currencies and large current account deficits. In a context of great competition between export-lead economies, the economic policies undertaken fuelled mercantilist postures inspired by the 'beggar-thy-neighbour' principle, the distorting effects of which were amplified

by capital market liberalisation. The fear that foreign investments would leave the countries in crisis increased systemic instability and exposed them to the risk of speculative activities. The difficulties encountered by Asian countries at this stage were explained by their failure to implement the reforms demanded by the Washington Consensus. For the narrative inspired by the Washington Consensus,the Asian crony capitalism hindered the affirmation of an effective market economy.Given such an explanation, the hypothesis according to which the list of reforms proposed by Williamson should be replaced by an enhanced Washington Consensus, itself able to make the adopted economic policies tougher gained some strength. It was time for bitter medicine. In the words of Dani Rodrik, one had to move from 'getting prices right' to 'getting the institutions right', i.e., reforms had to involve the institutional apparatus of any given country, so that it became functional to the logic of the market economy. The compliance with the principles of the World Trade Organisation (WTO) and to the standards of Anglo-American finance - the world's only true capital market - went hand in hand with what was the most significant factor of this phase, i.e., the autonomy of the Central Banks. Such an approach gave rise to a much more rigid and dogmatic model than the original one that postulated only one way for economic policies on a global scale, i.e., the one-size-fits-all approach that postulated the conditionalities induced by global financial institutions on the governance of States.Thus, the economic unification of the West with emerging economies through the opening of financial markets was taking shape. Within this theoretical frame inspired by monetarist and neo-classical economists, financial protectionism was judged in the same way as commercial and political protectionism; finance had taken on the function of the Aristotelian 'prime mover' of a nation's economic and civil progress, the guarantee of the democratisation of a society capable of unhinging political and institutional rents:

Therefore, the 'financial revolution' which occurred between the 1980s and the 1990s presented itself as the best and most efficient distillation of modernisation, as a more or less unconscious heir to the notion of 'permanent revolution'. Financial deregulation is thus not simply represented, in negative terms, as a process aimed at wiping out a suffocating system of controls, but as the way through which it would be possible to give rise to a new world order featuring the indefinite growth of transparency and 'power', where by 'power' we must first and foremost mean the constantly relaunched ability to improve the performative efficiency of the economic system”[2].

Such a modernization of the institutional and financial architecture had a hand in refocusing the flow of capital towards the USA[3], while the Asian countries were its periphery,in a system that seemed to somewhat replicate theBretton Woods agreements.[4] The Asian periphery shaped itself as a core of export-led development that accumulated reserves in dollars thanks to an undervalued exchange rate. As was the case of the 1944 agreements, Bretton Woods 2 was based on the centrality of the dollar whose stability and primacy was guaranteed by Asian economies financing the US deficit by buying Treasuries and assets denominated in the US currency. In this phase, which occurred during the early 21st century, Asia replaced Europe in its role as the productive periphery while the US remained the centre of the world economy. According to Dooley. Folkerts-Landau and Garber Bretton Woods 2, similarly the system born in 1944, guaranteed the stability of the system through a new productive periphery, currency peg and reserve currency accumulation, but it ended up being overwhelmed by the 2008 crisis. What actually ensured the functioning of the system was the fact that capital from the Asian periphery flowing to the American centre financed its deficit, allowing the increasingly indebted American consumers to keep their living standards.By the same token,the Central Banks of European and Asian countries, even in the face of global imbalances and the growing US current account deficit, kept taking on the risk of supporting the US debt, despite low interest rates. The bursting of the real estate bubble in 2008 was the result of the systemic crisis of Bretton Woods 2, which could no longer 'guarantee' ever-lower interest rates to the US economy, coupled with a growing level of indebtedness and undervalued exchange rates in the face of high savings rates in Asia. The Washington Consensus -by weakening the original 1944 version thereof- had made Bretton Woods 2 more fragile as it did not provide for institutional constraints on financial activities, which led the countries of Asia's productive periphery to

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[2] M. Amato, L. Fantacci, *Finedellafinanza. Da doveviene la crisi e come si puòpensarediuscirne*, DonzelliEditore, Rome, 2012, p. 39.

[3]Theconcept of refocusing of thecapitalflows is mentionedbyGiovanniArrighi as well in his booktitled*Illungo XX secolo. Denaro e potere e l'originedeinostritempi*todescribethereversal of financialflowsthat in the Golden Age yearsandthus of Keynesianpoliciesflowedfromthecentretotheperiphery. Intheyears of deregulationandliberalisation, on theotherhand, capitalflowedfromthe global peripherytowardsthecentre in search of higherreturns.

[4] M. Dooley, D. Folkerts-Landau e P. Garber,*The Revived Bretton Woods System*, in “International Journal of Finance and Economics”, 9(4): 307-313, October 2004.

pursue a mercantilist policy.

The Washington Consensus, by providing the basis for the financial logic that guided the integration of global markets, had an undoubted geopolitical and geo-economic significance, although in a sometimes-simplistic way it has been linked to the establishment of American hegemony on a global scale after the victory over the Soviet Union. More precisely, as Adam Tooze explains, capital flows were transatlantic in nature and the relationship between Wall Street and the City of London was not ancillary. From the beginning of the 21st century onwards, the international banking system, has always had a transatlantic dimension.Wall Street and the City had, and still have, a symbiotic link that has allowed the London Stock Exchange to become the lynchpin of global financing in offshoredollars[5].On the other hand, the geopolitical and geoeconomic value of the Washington Consensus directives, especially in their augmented version can be inferred from the fact that that they have held together the two defining aspects of globalisation, i.e., the free movement of financial flows and the China-US trade balance. The combination of these two factors has ensured the primacy of the US dollar and of Anglo-American finance. It seems no coincidence that Joshua Cooper Ramo coined the concept of the Beijing Consensus to describe an alternative to the Washington Consensus as a development model[6]and showing the critical issues of the relationship between China and the US.According to the American economist, China was asserting itself on a global scale thanks to its ability to foster a multipolar system of international relations and a State capitalism capable of regulating the excesses of the free market. Ramo's theorisation was useful in describing the features of the Chinese modelduringthe leadership by Deng Xiaoping, but must be deemed inadequate to represent the current phase, during which Xi Jinping has embarked on a season of open competition for global hegemony. Anyway, the Beijing Consensus debate had the merit of revealing the geopolitical and geo-economic issues related to the general rethinking of the economic unification process that had taken place since 1989 onwards. The phase of economic and political instability that has culminated with the Russian invasion of Ukraine has reignited the debate among economists about the need for a return to a world order able to guarantee stability and development. Within such a context, the return to Keynes represented something more than a fashion of the moment, and interest in what - in the English economist's intentions - was to be the institutional and financial architecture to be forged by the 1944 accords, was growing. On this, the book titled“Secondo Keynes: il disordine del neoliberismo e le speranze di unanuova Bretton Woods”is an interesting attempt to analyse Keynesian thoughtin the face of the current “world disorder”[7]. We know that the systemestablished in Bretton Woods was not the one Keynes[8] had planned,as the British economisthad proposedthe establishment of the International Clearing Union in order to balance the relationships between creditor and debtor countries by using offset payment methods, as well as the creation of a currency called bancor, to pay trade deficits. The current phase of globalisation, based on shorter value chains and on a regional scale, seems to prepare for the advent of a multipolar monetary system and for nation-States to regain the political and institutional room for manoeuvre. On this, Dani Rodrik statedthe following in one of the most essays of his:

“Our challenge today is to render the existing openness sustainable and consistent with broader social goals. This requires a decisive shift in the focus of multilateral negotiations. When trade ministers get together, they should talk about expanding the manoeuvring room for individual nations rather than narrowing it further through cuts in tariffs and subsidies. They should create the domestic space needed to protect social programs and regulations, renew domestic social contracts, and pursue locally tailored growth policies. They should be bargaining about policy space rather than market access. Such a reorientation would benefit rich and poor nations alike. Expanding policy space to accomplish domestic objectives does not negate an open, multilateral trade regime; it is a precondition for it”[9].

Therefore, a truly multipolar System should be based on the capability nation-States have to widen their “domestic space”, i.e.,the field in which to initiate development policies in support of social reforms. A change of direction from globalisation, as the priority for Rodrik should be the centrality of 'policy space' rather than accessing the international markets. For the Turkish economist, broadening a nation's scope in a domestic sense is the necessary requirement for an open and multipolar trading system. Within such a perspective, we can find much of Keynes, as he was an advocate of macroeconomic policies pursued by autonomous nations.

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[5]Pleasesee Adam Tooze,*Crashed: How a Decade of Financial CrisesChangedthe World*, PenguinBooksLtd, London, 2019.

[6]J.C.Ramo,*The Beijing Consensus*, The Foreign Policy Centre, London, 2004.

[7]Cfr. A. Carabellli, M.Cedrini, *Secondo Keynes: il disordine del neoliberismo e le speranzedi una nuova Bretton Woods*, Castelvecchieditore, Rome, 2014.

[8] For a reconstruction of thefierytheoreticalandpoliticalclashtheagreementswereshaped in, pleasesee: *La battagliadi Bretton Woods. John Maynard Keynes, Harry Dexter White e la nascitadi un nuovoordinemondiale*by B. Steil, DonzelliEditore, Rome, 2014.

[9] D. Rodrik, *The Globalization Paradox: Democracy and the future of World Economy,* W.W. Norton, New York and London, 2011, p. 153.

It was therefore a matter of respecting the heterogeneity of individual national realities and not applying abstract and universal models to each specific case. Keynes was also a supporter of international currency governance, but believed that it should not be established at the expense of the freedom of choice of national governments. A horizon that the reconfiguration in a regional sense of globalisation could reshape as the issue of the reconquering 'domestic space' by Nation-states, itself a theme closely linked to that of the plurality of monetary systems. The war in Ukraine gave a strong boost to this process that had already begun with the Covid-19 pandemic[10]and which took the form of a decoupling of the real and financial economies of the US and China and the juxtaposition of their respective spheres of influence; but, on closer inspection, the de-dollarisation process predates the Ukrainian conflict and is perhaps the most significant consequence of the 2008 crisis. Paradoxically, the sanctions imposed on Russia have spurred this joint project between China and Russia further. the de-dollarisation procedure intends to reduce US debt holdings, to reject the status of the dollar as a reserve currency, the use of different currencies for international transactions and commodities, as well as the increase in gold reserves. Such a process is also supported by the decreasing share of US public debt held by major central banks and the reduction by many G20 countries of their use of the dollar in trade agreements. Furthermore, the share in dollars of the international Swift payment system took a significant dive from January 2020 onwards. One should go back to the 2014 Crimean Crisis and to the beginning of the Trump Presidency to pinpoint the origin of the joint strategy by China and Russia. Such strategy aimed at neutralising the sanctions then, as it did at the onset of the Ukrainian War.Alessia Amighini, an economist, analysedthe willChina and Russia had to strengthen their financial partnershi[p11]. Such a relationship has been strengthened by bilateral agreements that have led to a drastic reduction of the trade in dollars between these two nations. In 2015, 90% of trade between Russia and China was carried out in dollars; such a figure had dropped below 50% by early 2020, it. Furthermore, Russia seems to have placed a strong bet on the yuan, starting to accumulate increasing shares of it, coming to hold a quarter of the world's reserves. This is a decision with a strong symbolic value because it reveals Russia's willingness to bet on the yuan as an alternative currency to the dollar and is a factor that boosts the de-dollarisation process further. Not onlyis China the most important destination for Russian exports, but the majority of the trade between the two Asian powersis carried out in yuan.Concerning the international monetary order, the consequences of the War in Ukraine have been significant,as attested by the data of the BIS, the Bank for International Settlements,according to which, during April 2022, yuan-denominated exchanges increased by 85% compared to 2019, a growth that made the Chinese currency the fifth most-used in the world.

The 'militarisation' of financial instruments has triggered a process that is creating a multipolar monetary system and which seems to be vigorously pursued by the Chinese. The launch of the digital yuan (e-CNY) and the creation of the Interbank Payment System (CIPS) - an alternative interbank payment system to the dollar-based SWIFT array - are two aspects of a single process based on the domestic use of the digital yuan and its use for cross-border payments, something made clear by a white paper from Peking that made waves in the international financial environment[12].However,the strongest attack on the dollar's primacy could come about through the launch of a commodity-backed currency - based on gold and a basket of raw materials, which - during such a phase of geopolitical instability- are gaining an increasingly revealing strategic value - which would represent the greatest alternative to the dollar, the emblem of *fiat money*, i.e. a currency that has no value in itself, but is based on the trust and stability of the government that issues it and regulates the use thereof.The future of a multipolar monetary system will not only be determined by the challenge of the yuan, but rather by the kind of relations the BRICS countries will shape. During the summit held in Samarkand on 15 and 16 September 2022, the countries belonging to the Shanghai Cooperation Organisation (SCO)[13],whose members account for 40% of the population and 25% of the world's GDP, a road map was drawn up for a process that, in the intentions of its participants, should lead to the creation of payment instruments as an alternative to the dollar and of financial infrastructures able to act the BIS as international clearing houses. Such a project further attests the extent of the attempt by countries that do not recognise themselves in US hegemony to create a currency multipolarity on a regional basis, something able to meet the needs responds of more and more nations to regain more room for manoeuvre and eliminate their reliance on foreign currencies.

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[10] P. Khanna, *MOVE: TheforcesUprooting Us,* Simon& Schuster, New York, 2021.

[11]For an analysis of thegoeconomicimplications of thefinancialstrategyfollowedbyChina, pleasesee A. Amighini,*Finanza e poterelungo le NuoveViedellaSeta*, UniversitàBocconiEditore, Milan, 2021.

[12] The*PBOC working* group on*e-CNY research*and*development*, *Progress of Research & Development of E-CNY in China*, 2021

[13]Therelationshipbetweenthe BRICS (i.e., Brazil, Russia, India, Chinaand South Africa) andSCOis a verytightone, nononlybecause of China'segemony. It is alsoduetothecommoneffortto define a regionally-basedeconomicorder as an alternativetotheAmericanone.

The crisis of the Washington Consensus has led to an attempt by the economies of emerging countries to create on a regional basis a solution to the trilemma of globalisation, sovereignty and democracy mentioned by Rodrik[14], giving back to the single States the room for manoeuvre that the interconnectedness and interdependence of markets had denied them. Currency multipolarity may become a reality if the process of de-dollarisation of international financial markets becomes irreversible and governments become unable to sustain domestic consumption and finance a colossal trade deficit[15]. On the other hand, such a development may also reveal itself to be just a phase of a transition whose final outcome we do not know. Many questions remain on the table in this regard, the main one being the historical factuality of the coexistence of several currencies of equal status. The hegemonic cycles in the history of capitalism -from the expansion phase of the European world-economy in the 16th century to the beginning of the 21st- have produced a sequence of hegemonies - Dutch, British and American - based on an undisputed centre and a single power. A Chinese-American domination, based on two aggregations and going against this historical sequence, besides being based on different monetary, systems would be an unprecedented case in the history of the world.[16]. Furthermore, history has taught usthat creating two blocs -set against each other-is not simply the preliminary step towards a new form of geopolitical balance and financial and economic stability; in fact, it took two world wars and an epoch-making crisis like the one in 1929 to create a 'minor globalisation', comparable to the one we are currently in and featuring the coexistence of two economic and political blocs.[17]. We hereby refer to a point of arrival, not to a beginning. The process that will lead to currency multipolarity is still long and uncertain. Furthermore, the recovery by Nation States of their 'domestic space' and freedom of choice and action, after the years of conditionality and external constraints is not certain to take place in the forms of cooperation and symmetrical exchange of reciprocity. To say it otherwise, the return to Keynes could take place as a defence of economic protectionism and national self-reliance, rather than in the forms of a new Bretton Woods agreement.

[14]Pleasesee. D. Rodrik, *TheGlobalizationPradox,* Norton &Company, New York, 2011.

[15]Such a situation is similartotheend of thefixedexchange system established in Bretton Woodsandshowstheimportance -evennowadays- of “Triffin’sDilemma”, as it illustratedthecriticalissues of thedollars’ asymmetriccentrality.

[16] G. Arrighi, *I cicli sistemici di accumulazione. Le trasformazioni egemoniche dell’economia-mondo capitalisti*, Rubettino, Soveria Mannelli, 1999.

[17]For further information on the concept of “minor globalisation” usedto describe the world order during its 1944-1989 phase, please see*Globalization: A Short History*byJürgen Osterhammeland Niels P. Petersson.