MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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The Great Depression's role sparking the Second World War led the victors to create the Bretton Woods agreement establishing stable reserve assets under-girding a world prosperous and peaceful enough to prevent another conflagration. After 2008, the world reinforced another set of global norms, setting cross-border financial standards over the next fifteen years by newly empowered transnational financial agencies. Now, what was left of Bretton Woods is in ashes and national geopolitical interests will again dictate critical financial requirements. Although it's of course possible that Russia's devastating invasion will end without still more cataclysmic carnage, it has done irreparable damage to the largely frictionless cross-border finance on which it and its oligarchs relied. China should take a lesson.

To be sure, this globalized and increasingly financialized construct was imperfect even for the hegemonic states and systemic financial companies in whose interests it worked the best. As Rana Foroohar pointed out last week, it was premised on the optimistic "end of history" reasoning that expected an interdependent world to be all-for one and one-for-all. Quite simply, if you must go through someone else's space to get where you want to go, then you are more likely to abide by the rules applicable in that space to ensure you get there. Over time, this creates a macrofinancial system in which currencies, payments, assets, and risks moved with few speedbumps from one end of the earth to the other. Even where rules might slow all of this down, safe-haven states constructed high-price bypasses. This, along with lots of regulatory arbitrage, was tolerated in the name of market efficiency and macroeconomic growth even as it became more and more clear that markets worked best for the few and macroeconomic growth was unequally shared within and among nations.

Last week was the end to this uneasy rapprochement between financial gain and geopolitical imperatives. First, as we noted, the G7 pushed Russia out of the international financial institutions established after the Second World War to create a global order founded on mutually-reinforcing self-interest backed by effective sovereign-debt backstops. The World Trade Organization is another artifact of this suddenly bygone era of mutually assured prosperity. Its credibility is scant compared to that of the IMF and World Bank, but it still mattered and now it's also gone for one pariah state and perhaps others as well.

The cryptosphere counts on friction-free global finance even more directly than any other medium of exchange or storehouse of value. Digital currencies such as bitcoin are premised on anarchic visions of transnational currencies that know no bounds. Indeed, some key players in this arena seem to think that they are not only above payment-system regulation, but also any arbiter of the public good. They are thus flaunting sanctions, apparently free of the moral imperatives most of us feel when watching maternity hospitals collapse in flames.

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This outrage creates the second crevasse in the once-stable global financial order. As President Biden and the G7 said last week, this is intolerable and will be terminated.

Further, it's not just private crypto players that pose significant challenges to the global order as the U.S. sees it. China's alliance with Russia in the Ukraine crisis combined with its continuing military threat make its CBDC a concern of first-order proportions, no matter the dollar's resilience in the current crisis.

President Biden's executive order on digital assets was crafted with complete recognition that the stateless nature of digital assets designed to serve a single state's interests makes them a looming threat not just to financial law and rule, but also to the express and immediate geopolitical interests of the United States of America. The White House is thus ordering a lot of work in a hell of a hurry on central bank digital currency as well as a tough stand in every global group crafting every digital-asset and payment-system standard.

Once, this America-First stand on digital assets would have been roundly condemned as a retrograde assault on the benefits that America, like most other nations, derived from globalized finance helping to ensure a newly peaceful world. Now, it seems like an essential bulwark against lawless finance serving murderous ambitions. Regardless, the U.S. will use its newfound dollar-based power to set as many of the rules as it can across the cryptosphere, with most of the G7 going along no matter how much they grumble.

Will this fragmented, self-interested financial infrastructure end as badly as the disastrous global finance construct established in Versailles at the 1919 conference? God save us and history will tell. What I know now is that, for all their flaws and despite the changes time wrought, the IMF, World Bank, BIS, WTO, FSB, Basel Committee, and all their hidebound, bureaucratic sister organizations were founded on hard lessons and high ideals. We've now lost the innocence they afforded. Perhaps the full force of all the sanctions Putin never anticipated will recraft global finance to a new order in which human rights, sovereign self-determination, and economic equality prevail along with well-regulated providers of money and payments. God bless us everyone.