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New Consensus On Global Money? A Note

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Abstract

This note deals with the Chinese proposal for a new international monetary architecture.

The Chinese proposal was the last of a series which suddenly appeared on the international diplomatic scene last March: starting from it the author presents a brief reflection on the common elements of such proposals.

Key-words:

Global money, Globalization, Chinese proposal

1. Money as a global public good?

The relationship between policy proposals and economic theories is hardly bi-univocal. Only sometimes economic theories manage to bring public debate to the surface and put pressure on policy-makers. More often the opposite happens: policy-makers demand economic theories in support of their choices.

An interesting question is whether the Chinese proposal for a new international monetary architecture is an example of the former or of the latter. When the Governor of the Bank of China officially proposed the creation of a new super-national reserve currency for the world last 23rd March, Joseph Stiglitz, Nobel Prize Laureate in Economics and President of an ad-hoc *UN Expert Commission*, had just left China where he

> "was a guest speaker at Hanqing Institute at Renmin University—an institute which he helped set up and of which he is the honorary dean—giving an address on 'China and Globalisation', in which he urged China to 'make up for the deficiencies of the United States'. On March 16, Stiglitz had been in Shanghai, where he criticised the notion of any single currency serving as a reserve currency. 'The dollar reserve system is part of the problem', he told his audience. Instead, he called for the establishment of a 'global reserve system', which would allow one country to use another country's money, referring to the regional Chiang Mai swap agreements between the countries of East Asia as a model for this" (http://larouchepac.com/node/9792)

It would be easy to overestimate single individuals' contributions to policy-making processes. But it might also be misleading. The question of who comes first (Stiglitz's suggestions or the policy proposal by the Chinese Governor) is not a mere curiosity. Whether the Chinese monetary authority is willing to change the international monetary arrangements and has asked economic theorists for support is very different from the case where some economists calling for a dramatic reform of the international monetary system are only given the opportunity to voice their proposals. In the latter case, an occasional coincidence of views might be the only characteristic of the event; in the former, a more lasting political commitment might be envisaged. Let's try to further reflect on this.

2. The Chinese proposal

One of the most striking features of the already-famous intervention by the Governor of the Bank of China, Zhou Xiaochuan, is the insistence on the structural inadequacy of the present international monetary and financial system. In the lines of his contribution, one can read of the "inherent weaknesses", "inherent vulnerabilities", "institutional flaws" and "inherent deficiencies" of the system (deriving from the so-called *Triffin dilemma*, i.e. the use of a national currency to provide international liquidity, to which Zhou Xiaochuan explicitly refers) which "calls for a creative reform" (http://www.pbc.gov.cn/english/detail.asp?col=6500& id=178).

The main problem is therefore attributed to the existence of a national currency (the US dollar) *both* as a global reserve asset *and* medium of exchange in international foreign transactions. As Triffin pointed out almost fifty years ago, this is an intrinsically vulnerable system to finance the global economy as it creates unsustainable asymmetries between the *issuer* and the *users* of the reserve currency. Firstly, if the international liquidity necessary to finance the growth of worldwide financial and trade transactions can only be provided by issuing new dollars, dollar inflation occurs, undermining its value stability (this is the main reason why its convertibility into gold was suspended in 1971). Secondly, US monetary policy is not constrained by the balance of payments, contrary to every other country; actually, only a balance of payments deficit in the US can provide international liquidity and an incentive exists for increasing global imbalances. This asymmetric process can last indefinitely only if the credibility of the issuing country (the USA) is not undermined economically and politically (in terms of balance of power).

To overcome such problems, the core of the Chinese proposal is "to create an international reserve currency that is disconnected from individual nations and is able to remain stable in the long run". He argues in favour of a sort of parallel currency, to be issued alongside national currencies, representing a basket of the major world currencies.

In truth, Zhou goes a bit further when he recalls the Keynes' proposal at Bretton Woods and the possibility to increase the role of the Special Drawing Rights (SDR). This is quite interesting because SDRs are an existing device which already represent some kind of basket of key international currencies, not a new currency to be agreed upon and created *ex-novo*. The composition of the SDR is now set by the IMF rules, which represent the old political framework dating back to over sixty years ago. But the global economic and political balance of power today is very different from what it used to be even a couple of decades ago. A dramatic reform of the IMF would therefore be necessary if a new, credible role should be addressed to SDRs.

In Zhou's words, it would be necessary to expand "the basket of currencies forming the basis for SDR valuation […] to include currencies of all major economies, and the GDP may also be included as a weight". The key question is to understand whether we are at the start of a process that will lead to a common world currency or just at a crucial point in history where a major redistribution of powers is on the cards.

3. Background and follow-up

The Chinese proposal was only the last, most popularised and probably most authoritative, of a series which suddenly appeared on the international diplomatic scene last March. First came the Kazakistan President, Nursultan Nazarbayev, with the proposal of an *Acmetal* (from the Greek, meaning 'best capital'), eager to contrast the predominance of the rouble in some envisaged central-Asian economic and monetary arrangement.

Then the Nobel Prize winner Robert Mundell gave an interview to *The Australian* (March 11th) were he enthusiastically favoured the idea of a new scientific and political effort towards a common device for the settlement of international monetary relations: "I must say that I agree with President Nazarbayev on his statement and many of the things he said in his plan, the project he made for the world currency, and I believe I'm right on track with what he's saying".

On March 18th the President of Russia, Vladimir Putin, suggested including the question of a common global currency in the agenda of the next G20 meeting in London. Several days later, on 26th March, an authoritative critique came from the Director of the Center for International Trade and Economics at the Heritage Foundation, Ambassador Terry Miller. His criticism can be summed up as follows: a) SDRs have no intrinsic value and the faith in IFM is not enough to sustain a credible global monetary device; b) "A one-size-fits-all international currency will not meet diverse world needs"; c) shifting from a national currency like the dollar to the SDR would result in a loss of transparency, because monetary creation would not be subject to an accountable organism like the Fed; d) the "SDR will create new financial complexities and opportunities for corruption".

On 29th March came the official support of Argentina for the Chinese proposal: the President of the Central Bank, Martin Redrado, said: "Clearly the dollar has suffered a considerable blow and alternatives are needed […] Argentina will work with China within the framework of the G20 and in other multilateral forums to seek these kinds of alternatives". India and Brazil were also later to offer support for this proposal.

On 30th March, a preliminary report by the Commission of Experts on Reforms of International Finance and Economic Structures, a UN body chaired by Joseph Stiglitz, "called for a new globalised system for regulation of currencies. Promoted as a way to help developing nations, the globalised currency proposal is actually an attack on the United States, national sovereignty, and world economic development" as emphatically stated by http://larouchepac.com/node/9792.

The final report of the G20 meeting in London on 2nd April, beyond a new SDR allocation of 250 billions dollars, was definitely disappointing, compared to such previous debate and suggestions. In the *Leaders' Statement*, one can read for example: "we commit to implementing the package of IMF quota and voice reforms agreed in April 2008 and call on the IMF to complete the next review of quotas by January 2011". But the reform package can be seen at http://www.imf.org/external/np/fin/quotas/pubs/.

If one looks at the different simulations (http://www.imf.org/external/np/pp/2007/eng/071107a.pdf), one can see that the USA continues to remain above the veto quota of 15% (all major decisions require at least an 85% qualified majority).

4. Are we moving towards a common world currency?

Doubts are therefore to be cast on the easy syllogism that these sudden and authoritative proposals for a dramatic reform of the international monetary system will lead to some common global currency.

Some commentators are sceptical with regard to this being the goal of the Chinese Central Bank. First of all China needs a credible device to convince the markets not to speculate against the US dollar, because this would result in a huge capital loss for the Chinese reserves. These amount to around 2,000 billion dollars and 1,400 billion are denominated in US dollars. A depreciation of the dollar by about 20% would mean trashing almost 300 billion dollars of Chinese reserves. Not really pocket-money. Furthermore, a devaluation of the dollar would mean a revaluation of the renmimbi and of the euro, which both China and Europe are very reluctant to accept.

This does not mean that there should only be room for pessimism over the possibility to build a new monetary architecture in the world, based on a more balanced weight of the most important currencies in view of a process of increasing stabilisation of the exchange rates and of a final global arrangement towards a common worldwide currency.

Some optimism derives from the unprecedented huge political window which the global recession opened to the perspectives of a global monetary system where the *Triffin dilemma* is avoided from the start, as no *national* currency is to become the *international* reserve currency. But such a window of fundamental political strategies will not last forever, and nobody can predict how long it will remain open. Global imbalances are difficult to tackle with fixed exchange rates or with some "snake", as in the case of the EMS experience. Although we can probably dare to argue in favour of endogenous criteria for optimum currency areas, implying that some common monetary device for international transactions might help macroeconomic convergence, the extension of such a case from the European experience to the world economies is definitely very brave.

Macroeconomic performances, variables and preferences are extraordinarily different worldwide and no one can say with which degree of both flexibility and steadiness a common monetary standard should be designed and managed.

The role of the USA is obviously crucial. Any reform of the existing system cannot be pursued without their agreement. On one hand, they can no longer play the hegemonic role of global providers of monetary liquidity and financial stability. But on the other, the huge US fiscal stimulus to climb out of the recession can only be financed by applying higher taxes, now or in future generations; in both cases, a dollar devaluation could be of great help. It would ease exports and a rebalancing of payments via the current account and it would decrease the burden of fiscal readjustment. In fact, the day after Zhou's proposal, Geithner and Bernanke dismissed the idea with a firm "no".

5. Concluding remarks

From a strictly economic point of view, all the proposals made last March by authoritative officials and academicians seem to stand for a widespread recognition of the nature of money as a global public good, the stability and "production" of which should therefore not be left to "local" (national) sovereign monetary authorities but to some internationally agreed set of rules.

On a broader scale, we are obliged to try and assess whether such technical point of view is also sustained by strategic considerations concerning the coincidence of the Chinese, Russian, South American and European interests in a new monetary architecture where the role of the dollar is reduced on an equitable basis with other *continental* currencies.

Some very schematic conclusions are suggested by the recent debate. The first conclusion we can draw is that we are still far from reaching a global consensus. The compromises required to move from the old hegemonic stability model to a more balanced multi-centric one are huge and time-consuming.

The second conclusion has a strong normative content: the most effective way to accelerate the process would be to speed up regional monetary arrangements. Regional (continental) processes of monetary integration have been under discussion for many years (even decades in some cases). Paradoxically, today's sudden acceleration of the debate on global reform might slow down such regional experiments: a quick move towards the reallocation of SDRs might discourage regional efforts. We could therefore have a redistribution of voting powers in the IMF without those institutional changes that have characterised the European experience and have been (until now) the reference model for continental or sub-continental integration processes.

Thirdly, Europe can have a crucial role to play thanks to the euro, the only currency with a global status other than the US dollar. Europe should therefore take up its responsibility and clearly state its opinions with regard to the reform, the steps it envisages and the allies to be sought. But this requires Europe to speak as a single body on the international scene, which still seems unrealistic at present.