Reining in the dollar ▪ By Robert H. Wade

The case for a global currency

LONDON

There is a rising tide of opposition around the world to America's unilateral assertion of its national interests. But few realize that for the United States to become a more responsible country, the world economy needs to move from the current U.S. dollar standard to a global currency.

U.S. dominance rests not only on military superiority and on the size and productivity of its economy, but also on the fact that most international transactions are denominated in U.S. dollars and more than 60 percent of world foreign exchange reserves are held in U.S.-denominated assets, like U.S. Treasury bills.

The problem for the rest of the world is that the U.S. dollar standard encourages the United States to be careless in its monetary and fiscal policies.

When a national currency is used only as a national currency, a government knows that it can jeopardize its existence by printing too much money, as this has inflationary and instability costs within the economy. But when a national currency is also the international currency, as is the case with the U.S. dollar, the government knows that the costs of excessive printing of money — and excessive fiscal deficits and current account deficits — will spill over onto others, such as countries that hold its currency in their reserves.

U.S. policies have been pumping out excessive liquidity into the world economy since the 1960s, but especially since the 1980s, helping to lubricate international transactions but also building up a store of trouble for others. The excess stock of financial assets denominated in U.S. dollars is moved around the world by financial organizations looking for higher returns, going in and out of national financial markets like a herd of cattle. The inflows and outflows can easily destabilize the financial systems of developing countries, as we saw in the Latin American debt crises of the 1980s and 1990s, and in the crisis of 1997-99 that involved East Asia, Brazil and Russia.

Through the 1990s, the U.S. Treasury aggressively promulgated a development strategy for developing countries of "economic growth with the help of foreign savings." It urged developing countries to lift restrictions on the inflow and outflow of financial capital, so that national governments and companies could borrow more cheaply and world resource allocation could be improved.

For developing countries this turned out to be a debt trap, but for the United States there were political and economic benefits. Many governments found themselves constrained by their foreign debt burdens, and more prone to support U.S. policy positions in international organizations like the United Nations, the International Monetary Fund and the World Trade Organization. And when the crisis came, U.S. companies tended to profit by acquiring the now much cheaper national assets. U.S. political and economic dominance over the developing world was reinforced.

The root of the problem, though, is not the imperialist behavior of the United States, it is the asymmetry created by the fact that one national currency is also the international currency. Any other state whose currency was the international currency would probably behave much as the United States does.

The world economy needs an international currency distinct from national currencies and national interests. The currency should be designed to incorporate the advantages of the gold standard, such as impartial levying of costs on states which are profligate, without its disadvantages, such as excessive rigidity.

We should be thinking of creating a global currency unit, or GCU, based on the inflation-adjusted real gross domestic product of the major economies. Governments and companies would issue bonds denominated in the GCU and hold them in their reserves. Countries could make cross-border payments in their own currency, with the payments settled inside an international clearing union using the GCU as the numeraire, or base unit of measure.

Exchange-rate changes would be made in-house in accordance with changes in reserves, at regular intervals. The exchange rates would reflect costs and production and demand for goods and services, not speculation against future movements.

While there are no moves as yet toward a global currency, for several years the 10 member states of the Association of Southeast Asian Nations, plus Japan, China and South Korea, have been exploring the creation of an Asian Currency Unit, or ACU, based on a weighted average of key regional currencies.

The ACU is intended to be a benchmark independent of the U.S. dollar, around which Asian countries coordinate their exchange-rate policies. They would denominate their export prices, loans and bond issuance in ACUs. China and Japan, for all their other disagreements, are keenly interested in the proposal.

The ACU and other regional currencies, however, are only partial solutions. Because they could still be subject to destabilizing speculation and revaluation against the U.S. dollar, they do not solve the problem of U.S. incentives to be irresponsible in fiscal and monetary policies. What we need is a global currency.

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