

Web link: <http://knowledge.insead.edu/economy-currency-martin-wolf-091217.cfm?vid=361>

Does the world need a new global reserve currency?

A new global currency should replace the US dollar as the international reserve currency, as the long-term deterioration of America's economy and the greenback is fuelling a "currency-regime crisis", says **Martin Wolf**, associate editor and chief economics commentator of the Financial Times.

Wolf, who has honorary doctorates from three universities, bases his argument in part on the Triffin dilemma, an economic paradox named after economist Robert Triffin. The paradox shows that the US dollar's role as a global reserve currency leads to a conflict between US national monetary policy and global monetary policy. It also points to fundamental imbalances in the balance of payments, particularly in the US current account.



Speaking recently at an event organised by the Singapore Institute of International Affairs, Wolf said Triffin believed that the host nation of a global reserve currency will inevitably run up a huge current account deficit that would consequently undermine the credibility of its currency and adversely impact the global economy.

"You can't have an open globalised economy which relies for its ultimate liquidity on the currency of one country. That was his (Triffin's) argument. And therefore he said the Bretton Woods system would break, which it did. And exactly the same thing happened with Bretton Woods II, which is the system of pegging."

"So I agree with this. And I'm absolutely convinced now, in a way that I was not three or four years ago, that we cannot continue with a genuinely global economy which relies on national money, and that's not sold by just adding another couple (of currencies). It actually means having a global money."

Indeed, Wolf says he's in complete agreement with China's central bank governor Zhou Xiaochuan, who has argued for a new global currency "most credibly and convincingly."



"On the dollar, there is nothing to support this currency except the Chinese government and a few other governments that are prepared to buy it," says Wolf. "Anybody can look at the arithmetic of the fiscal deficit, the monetary policy, the external balance, which has improved but largely because of the recession, the dollar is not adequately supported."

The US currently has a national debt in excess of US\$12 trillion or almost US\$40,000 per citizen, with a debt to GDP ratio of more than 85 per cent. In the July-September

quarter, the US current account deficit rose sharply by 10.3 per cent from the previous quarter to US\$108 billion. In the past year, the US dollar index, which measures the performance of the greenback against a basket of currencies, has also fallen significantly.

Apart from the economic risks posed by the decline of the US dollar, China's devaluation of its currency is causing "a real problem" for Europe. The "very perverse currency adjustment" is highly destabilising for the Eurozone economy and could create a crisis, says Wolf.

"There is nothing to prevent this, unless the Europeans decide they are going to intervene in the foreign currency market to buy dollars and that would be over (European Central Bank president) Jean-Claude Trichet's dead body."

As there is "no chance" of European governments intervening in the foreign exchange markets to improve the competitiveness of the euro, it will result in major currencies like the euro and Japan's yen becoming "very vulnerable".

"This is simply the American way of shifting the recession from them(selves) to their trading partners," says Wolf. "What we need are global currency adjustments and it has to include the renminbi and global macro adjustments in those countries which make this less painful."

"In terms of the impact of this on the role of the US dollar as the currency of denomination for international transactions, basically I think it's become very unreasonable."

"Because the dollar, to my mind, given its underlying conditions, is no longer a credible long-term store of value," Wolf says.

The decline of the US dollar underscores a phase of global power transition, with the balance of power moving from the US to Europe, China and India, Wolf argues, adding that the greenback's loss of credibility as the dominant global reserve currency is part of this messy transition.

"The Americans no longer have the means to save themselves, this is what I think people don't understand. There is no credible American policy," says Wolf.

"We need to discuss this globally in a harmonious way. It's not happening, so at the moment the Eurozone is a prime victim and it will continue to be, and that will create very big problems for European-based manufacturers, and quite particularly those that are relatively vulnerable to global price effects."

"And it's a tremendous mess, a horrifying mess and that's where we are, I'm sorry. And we've got to get through this transition as quickly as possible to a more stable global monetary system with a lesser reliance on the dollar. We're going to get there over the next 10 years, I'm sure of it. We're going to get there. The only question we have to decide is, how we're going to get there."

Chinese currency devaluation could spark trade skirmish

A trade skirmish between the US and China could ensue, if Beijing continues to devalue its currency to bolster export-driven economic growth at the expense of economic recovery in the US, says Martin Wolf, chief economics commentator of the Financial Times.

Wolf says China is working hard to defend the artificially low value of the renminbi in the hope of that exports will pick up when external demand recovers. According to China's customs authorities, exports from January to November plunged by 18.8 per cent to US\$1.07 trillion from a year ago. However, according to The Royal Bank of Canada, export growth should pick up in the coming months and reach double-digits in early 2010.

China's efforts, Wolf says, will spark a "very vigorous, even vicious" reaction from the US as it's destabilising US efforts to engender an economic recovery.

[Read more..](#)

First published: December 17, 2009
Last updated: December 21, 2009

KT/KC 12/09