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VOICES OF THE SOUTH ON GLOBALIZATION

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GOOD BYE, U.S. DOLLAR?

In this issue

THE "EURODOLLAR"

Prime Minister Silvio Berlusconi presented each of the heads of state and government of Britain, Canada, France, Germany, Japan, Russia and USA as well as presidents of the European Council president and the European Commission with an unusual gift at the G8 summit early July in L'Aquila: gold coins representing an imaginary future world currency. Named 'Eurodollars', in a symbolic call for a common currency to unite Europe and the United States, the coins are made at the Royal Mint of Belgium. The designer is Belgian Luc Luycx, author of the common side of the Euro coins.

On the obverse, the 'number 1' icon is repeated five times, representing the five continents. The border inscription reads 'Unity in Diversity' and includes the first issue date of 2009. On the reverse is the Tree of Life, with five leaves symbolizing local tree species that grow in the five continents. The border inscription reads 'United Future World Currency'. The final name and symbol for the new currency will be decided in a competition for children in 1000 schools throughout the world, organised by the Museo del Tempo. The first step started from the American School of Milan, and involved 640 students from 46 different countries. The currency will also undergo an important public test run at the 2015 Milan Universal Expo.

Although the initial aim is to unite the United States of America with the 'United States of Europe', it will also be open to other countries, says Sandro Sassoli the coordinator of the United Future World Currency (UFWC), a group pushing the idea of a global currency. Sandro Sassoli conceived the idea of the UFWC project in 1996, having taken advice from Arthur Schlessinger Jr, former advisor to President John F. Kennedy.

Russia's President, Dmitry Medvedev, who is said to have been seeking ways to displace the dollar as the world's dominant reserve currency, pulled the Eurodollar from his pocket at the meeting of G8 leaders on July 9 and said: "Here it is (the world's future currency. You can see it and touch it." The possibility of a supranational currency "concerns everyone now, even the mints," Bloomberg financial news agency quoted Medvedev saying. The test coin "means they're getting ready. I think it's a good sign that we understand how interdependent we are."

Russia, China and India have all questioned the dollar's future as a global reserve currency -- a status it has enjoyed since inheriting it from sterling last century. China's central bank earlier this year laid out an alternative to the dollar in the form of a special international reserve currency administered by the International Monetary Fund. However, most experts believe it will take years for the dollar to be eclipsed. ☑

Voices of the South on Globalization is a monthly newsletter intended to inspire a meaningful North-South Dialogue by raising awareness for global interdependences and by offering a forum for voices from the South in the globalization debate. Each edition will present short analyses or commentaries from a Southern perspective on one particular issue of the globalization process.
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RESERVE CURRENCY NO LONGER A SIDE ISSUE

On the eve of their meeting with the G8 in L'Aquila Italy, the G5 group of major emerging economies -- Brazil, China, India, Mexico and South Africa -- discussed the use of their own currencies to settle trade accounts among themselves. According to Indian Foreign Secretary Shivshankar Menon, the suggestion to explore this possibility came from Brazilian President Luis Inacio Lula da Silva.

Reflecting the caution that Delhi has shown toward the international currency issue, and its balancing act between Washington and Beijing, Menon wanted to clarify that this does not mean the G5 having a new currency or alternative reserve currency.

China, Russia, Brazil, France, and to a lesser degree India had expressed interest in the talks between G5 and G8 leaders to include debate on seeking long-term alternatives to the U.S. dollar as the global reserve currency. Brazil and China have, of course, already established arrangements to settle a portion of their trade in their own currencies. China and Russia are doing the same.

In the 'G5 Political Declaration' issued at the end of their Day 1 meetings in L'Aquila, "the 5" gave a strong message calling for the "full, immediate implementation of the G20 Summit Declaration of London, with no delay". The G5 also emphasized their joint intention to "continue promoting the reform of the international financial system", and "establish a new international financial order" that will be "just, fair, inclusive, and well-administered".

The G5 pledged to "dedicate the necessary efforts to resolve the issue of the inadequate representation of developing countries in international financial institutions", which they added, "must be carried out immediately".

What makes the G5's currency discussion -- at the G8 Summit -- all the more relevant is that certain G7 members had tried to block the currency issue from being added to the agenda for the G8/G5 meeting on Day 2 at L'Aquila, namely Japan, Canada, and Britain.

In the lead up to L'Aquila, statements from a top Chinese diplomat that it would be "normal" if the Summit dialogue unfolded to include currency issues had set off a reaction from the established members of the Club.

Japanese representatives retorted that the currency issue is a side issue that could be discussed at 'side meetings' of the emerging economies. Canadian finance minister Jim Flaherty and British Prime Minister Gordon Brown both questioned the appropriateness of raising the global currency at a time when the global economic crisis demanded stability.

U.S. President Obama is known to have remarked this May, at a White House press briefing, in a rather uncharacteristic fashion: "There is no need to discuss the currency issue." Two days later, his Treasury Secretary tried to smooth over the diplomatic waters by noting that China's central bank governor, the author of the proposal, is a thoughtful official and that any ideas from him deserved serious consideration. The reality is that the currency and macro imbalance challenges are systemic issues that demand the attention of the truly global powers.

The G8 met this year in an atmosphere of global uncertainty. In the lead up to the L'Aquila Summit, leaders from Russia, Brazil, China and other countries expressed concerns about the stability and role of the U.S. dollar, and the world economy's dependence on the dollar as the global currency.

RETURNING FIRE

By raising the reserve currency issue, China is now returning fire at the U.S., and the veiled criticism of China's massive trade surplus and tight grip on the RMB exchange rate in the talk of macroeconomic imbalances, by implicitly calling into question whether the United States is fit to be the anchor of the global economy.

What lends the debate a more immediate relevance is that the Chinese government has gone beyond rhetoric, and is now undertaking a series of concrete measures that indicate that Beijing is interested in gradually expanding the role of the Chinese renminbi (RMB) as an international currency -- and potentially reducing its reliance on the U.S. dollar.

Beijing has become increasingly nervous about maintaining its large dollar denominated holdings. Despite their awareness that it would be no small feat to shift beyond the Dollar System, Chinese authorities have nonetheless started to take hesitant and measured steps to "internationalize" usage of the RMB.

They have established: 1) currency swap agreements worth $95 billion with Indonesia, South Korea, Hong Kong, Malaysia, Belarus, and Argentina; 2) an agreement with Brazil to encourage trade settlement in each other's currencies; 3) plans to buy SDR-denominated bonds; 4) "settlement trials" to allow a small number of export firms in the trade-heavy Shanghai and Guangdong areas to settle their trade in RMB; 5) a "net settlement system" to increase liquidity and trading volume in the domestic interbank currency market and for select Hong Kong-based banks to sell RMB-denominated bonds in Hong Kong.

These concrete steps build, of course, on the statements from central bank governor, Zhou Xiaochuan on March 23 this year, calling for currency diversification in international trade and foreign reserves toward a supranational reserve currency based on the IMF's Special Drawing Rights. **Read more on page 6**.

THE LOGIC BEHIND CHINA'S CALL FOR NEW GLOBAL CURRENCY

Since China's central bank governor Zhou Xiaochuan proposed last March replacing the U.S. dollar as the international reserve currency with a new global system controlled by the International Monetary Fund, a debate has been unleashed about the future of the 'Greenback'. There is also speculation about what China could possibly have up its sleeves.

China's goal, wrote Zhou in an essay posted on the People's Bank of China's website, would be to create a reserve currency "that is disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies".

The proposal was seen by analysts as an indication of China's fears that actions being taken to save the domestic U.S. economy would have a negative impact on China.

"This is a clear sign that China, as the largest holder of U.S. dollar financial assets, is concerned about the potential inflationary risk of the U.S. Federal Reserve printing money," said chief China economist for HSBC Qu Hongbin said, according to the Financial Times (FT).

Analysts noted that although Zhou did not mention the U.S. dollar, the essay gave a pointed critique of the current dollar-dominated monetary system.

"The outbreak of the [current] crisis and its spillover to the entire world reflected the inherent vulnerabilities and systemic risks in the existing international monetary system," Zhou wrote.

China has little choice but to hold the bulk of its $2,000bn of foreign exchange reserves in U.S. dollars, and this is unlikely to change in the near future. To replace the current system, Zhou suggested expanding the role of special drawing rights (SDRs), which were introduced by the IMF in 1969 to support the Bretton Woods fixed exchange rate regime but became less relevant once that collapsed in the 1970s.

The value of SDRs today is based on a basket of four currencies -- the U.S. dollar, yen, euro and sterling -- and they are used largely as a unit of account by the IMF and some other international organisations.

China's proposal would expand the basket of currencies forming the basis of SDR valuation to all major economies and set up a settlement system between SDRs and other currencies so they could be used in international trade and financial transactions.

Countries would entrust a portion of their SDR reserves to the IMF to manage collectively on their behalf and SDRs would gradually replace existing reserve currencies.

Zhou said the proposal would require "extraordinary political vision and courage" and acknowledged a debt to John Maynard Keynes, who made a similar suggestion in the 1940s.

Here excerpts from Zhou's essay titled **'Reform the International Monetary System':**
www.pbc.gov.cn/english//detail.asp?col=6500&ID=178

I. The outbreak of the crisis and its spillover to the entire world reflect the inherent vulnerabilities and systemic risks in the existing international monetary system. . . .

II. The desirable goal of reforming the international monetary system, therefore, is to create an international reserve currency that is disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies.

1. Though the super-sovereign reserve currency has long since been proposed, yet no substantive progress has been achieved to date. Back in the 1940s, Keynes had already proposed to introduce an international currency unit named "Bancor", based on the value of 30 representative commodities. Unfortunately, the proposal was not accepted. The collapse of the Bretton Woods system, which was based on the White approach, indicates that the Keynesian approach may have been more farsighted. The IMF also created the SDR in 1969, when the defects of the Bretton Woods system initially emerged, to mitigate the inherent risks sovereign reserve currencies caused. Yet, the role of the SDR has not been put into full play due to limitations on its allocation and the scope of its uses. However, it serves as the light in the tunnel for the reform of the international monetary system.

2. A super-sovereign reserve currency not only eliminates the inherent risks of credit-based sovereign currency, but also makes it possible to manage global liquidity. A super-sovereign reserve currency managed by a global institution could be used to both create and control the global liquidity. And when a country's currency is no longer used as the yardstick for global trade and as the benchmark for other currencies, the exchange rate policy of the country would be far more effective in adjusting economic imbalances. This will significantly reduce the risks of a future crisis and enhance crisis management capability.

III. The reform should be guided by a grand vision and begin with specific deliverables. It should be a gradual process that yields win-win results for all

The reestablishment of a new and widely accepted reserve currency with a stable valuation benchmark may take a long time. The creation of an international currency unit, based on the Keynesian proposal, is a bold initiative that requires extraordinary political vision and courage. **Read more on page 6**.

CHINESE YUAN TO GO GLOBAL?

Because the G8 did not entertain the Chinese proposal for reform of the monetary system and it essentially reaffirmed the U.S. dollar's status as a reserve currency, China is likely to act unilaterally on the matter, much to the detriment of stability in currency markets and future cooperation in global monetary reform, some analysts predict.

The boldness of these moves would imply a sense of urgency by the Chinese. They believe that action will be seen on this front soon - and suddenly, too. The possibility of a sudden Dollar devaluation prior to the end of 2009 will only make the Chinese act more forcefully.

The Yuan looks as though it will be fast tracked from a protected national currency to an international reserve currency with the first sprint to be completed in 2010, says Julian Phillips of the Global Watch - The Gold Forecaster**.** The pace will be dictated by two factors, firstly the pace at which the China dictates and secondly by the IMF schedule for the review of the composition of the SDR in 2010. By that time the Yuan must have a heavy presence in international markets in at least trade flows.

However for the Yuan to move in large amounts, eventually as capital, says the analyst, it must be well used internationally and in such volumes that large capital amounts can move through the currency markets without disturbing the Yuan exchange rate. This means that the Yuan must be readily available in large amounts in all the international markets that China wants to see the Yuan traded in.

What does this imply? China must release huge amounts of the Yuan into international markets between now and 2010. This would require following a similar route to the one taken by the U.S. dollar from 1971 onwards, which led to the Dollar being the most sought after international currency. With the U.S. in control of the security of the biggest oil producing area in the world, the lands surrounding the Persian Gulf ensured that oil was priced in the U.S. dollar. This forced it into the coffers of every nation on earth.

While China does not have the same leverage, it does sell the cheapest and most sought after manufactured goods everywhere, says the analyst, predicting that as Chinese expertise grows, Chinese goods will take a larger and larger path into international markets. "Until the rest of the world earns as little as Chinese workers do, the 'China advantage' will assist in this growing international presence. The threat to the Dollar is huge, because eventually in almost every transaction where the Yuan will be used, it will replace the U.S. dollar."

The analyst adds: "This will leave a growing amount of the U.S. dollar with nowhere to go but home. If this happens, forget rising interest rates, even in the face of inflation? But will they price Chinese goods in the Yuan and change their pricing from the U.S. dollar? Yes, tentative steps are already being taken in this regard," the analyst says and lists some of the steps under way:

- **Currency Swaps:** China has issued large tranches of Yuan 'Swaps' to a few countries, including South America. This allows them to pay for Chinese goods in the Yuan, while China can add foreign currencies to their foreign exchange reserves. "Like a movie being tested in a country town, the next step will be to go global," the analyst says.

- **Loans to foreign banks in Yuan:** The main exit point for goods from China is via Hong Kong. Such loans are now being issued to Hong Kong Banks, where they can be closely monitored from China. Likewise these are trial runs to remove teething problems.

Foreign banks will be able to buy or borrow Yuan from Chinese mainland lenders for the first time to settle trade in Hong Kong and Macau under a pilot scheme set up by the People's Bank of China (PBOC).

This is a prime step in the international use of the Yuan. The PBOC will permit foreign banks to settle imports and exports in Yuan in Hong Kong and Macau and will allow them to buy Chinese currency from mainland banks within certain limits.

The rules make clear that China will be checking to ensure that banks and companies do not try to use the pilot program to get round the country's capital controls.

Exporters will be allowed to keep their Yuan earnings outside China. Chinese banks will also be allowed gradually to extend trade finance in Yuan to overseas companies, the PBOC said.

The program will initially be piloted by about 440 firms in Shanghai and the southern province of Guangdong. Chinese export firms involved in the trial will continue to qualify for export tax refunds.

This will increase the pressure on the Yuan to appreciate, analysts say, but China wants the Yuan to be an international currency by 2010 so it must push a huge quantity of them into foreign markets. This can be made to counter an excessive appreciation if enough Yuan are created, says the analyst. He adds:

"Additionally, we can be sure that in selling, loaning and swapping the Yuan, China will move to desist from accumulating more U.S. dollars than is required for U.S. trade. It will sell the Yuan for the currencies of its trade partners across the world. This will stabilize or lower the Yuan exchange rate against these currencies, while placing some downward pressure on the U.S. dollar as its global reserve currency role wanes." ☑

THE 'BRIC' CHALLENGE

The first summit last June of the fast-growing BRIC nations -- comprising Brazil, Russia, India and China -- thrust the sustainability of the dollar's reserve status to the top of the currency market's agenda, analysts say. Indeed, just one day after reassuring the market that there was "no alternative" to the dollar, which was in "good shape", Russia sent out a conflicting message, saying the reserve currency issue would be on the agenda at the summit.

President Dimitry Medvedev said: "We have to consolidate the international monetary system, not only through the consolidation of the dollar but the creation of new reserve currencies."

This prompted analysts to say the comments were good news for risk appetite and the International Monetary Fund, whose bonds denominated in special drawing rights (SDRs) could benefit from BRIC reserve managers diversifying away from the dollar.

"The appetite for SDR denominated bonds is good news for the IMF which under current conditions seems to have no funding problems at all," said Hans Redeker at BNP Paribas. Financial Times quoted him saying that this could weigh on the dollar as investors abandoned the currency in search of yield. "A strong IMF funding position will leave investors in a comfortable position to 'play risk," said Redeker.

A few days later, ahead of the G8 summit in Italy, Russia and India said the world economy is too reliant on the U.S. dollar and called for changes in how $6.5 trillion in currency reserves are managed.

"The dollar system or the system based on the dollar and euro has shown that they are flawed," Medvedev said in an interview with Corriere della Sera, repeating his proposal for a new international reserve currency.

Russia had support. Suresh Tendulkar, an economic adviser to Indian Prime Minister Manmohan Singh, said in a July 3 interview that he was urging his country to diversify its foreign holdings away from the dollar. Tendulkar said he was advising Singh to diversify India's $264.6 billion in foreign-exchange reserves and hold fewer dollars, Bloomberg reported.

"The major part of Indian reserves is in dollars -- that is something that's a problem for us," he said, adding that big dollar holders face a "prisoner's dilemma", a reference to a problem in game theory in which a rational choice for an individual has negative consequences for a group.

While Medvedev said he sees "no alternative" to the dollar or euro now, he repeated his proposal that "regional reserve currencies" be developed and again questioned the wisdom of relying on the dollar.

"In the long term, we must also think about a single unit of payment such as the International Monetary Fund's Special Drawing Rights," a unit of an account linked to a basket of currencies, he told the Italian newspaper. "We cannot be hostages to the economic situation of a single country, as is happening today with the United States."

But what do China, India, Brazil, Russia – and even France -- have in common? They blame the United States for wrecking the global economy. And they think the dollar is the wrecking ball.

One rock-solid, foundational belief underpins almost all economic theory in America: faith in the dollar's unassailable status as the world's reserve currency. Foreigners hold so many dollars that they can't afford to stop buying them, the theory goes. Therefore the dollar's status as the world's reserve currency is sound.

The irony is that America is completely blind to the catastrophe heading its way, analysts say. As the economic crisis unfolded at the end of last year, investors made a mad rush out of global stock markets and into other assets. The biggest beneficiary of the panic was the one market large enough and liquid enough to handle the trillions of dollars being moved: the U.S. dollar market. This caused the dollar to surge in value.

America grossly misdiagnosed the demand for dollars as a vote of confidence in the U.S. economic system. In fact, it was primarily a case of investors looking for a place they could quickly and easily get their money in and out, writes an Indian analyst in an article posted on the web.

"Debate" about Bretton Woods is flowery code for an attack on the dollar. What is even more surprising is that the dollar assaults have come also from its more democratic allies. At the G-8 summit, French President Nicolas Sarkozy called for a complete revamp of the global currency system, saying that the dollar's supremacy is outdated. "[W]e've still got the Bretton Woods system of 1945," Sarkozy stated on July 9. "Frankly, 60 years afterwards, we've got to ask: Shouldn't a politically multipolar world correspond to an economically multicurrency world?"

Bretton Woods was the historic conference that laid the foundation for a postwar global economy centered on the dollar. "Even if it's a difficult topic," Sarkozy said, "There has to be a debate." "Debate" about Bretton Woods is flowery code for an attack on the dollar.

Japan is America's second-most important creditor nation --lending the U.S. billions of dollars each year. If Japan won't lend unless America pays it back in yen, then China and other major lenders may quickly follow suit. This would eliminate America's ability to use inflation to cheat on its debt payments. America's debt burden would soar, interest rates would jump, and national default -- Argentina-style -- could be staring America in the face within months instead of years, analysts warn. ☑

THE LOGIC BEHIND CHINA'S CALL '

(Continued fro page 3)

In the short run, the international community, particularly the IMF, should at least recognize and face up to the risks resulting from the existing system, conduct regular monitoring and assessment and issue timely early warnings.

Special consideration should be given to giving the SDR a greater role. The SDR has the features and potential to act as a super-sovereign reserve currency. Moreover, an increase in SDR allocation would help the Fund address its resources problem and the difficulties in the voice and representation reform.

Therefore, efforts should be made to push forward a SDR allocation. This will require political cooperation among member countries. Specifically, the Fourth Amendment to the Articles of Agreement and relevant resolution on SDR allocation proposed in 1997 should be approved as soon as possible so that members joined the Fund after 1981 could also share the benefits of the SDR. On the basis of this, considerations could be given to further increase SDR allocation.

The scope of using the SDR should be broadened, so as to enable it to fully satisfy the member countries' demand for a reserve currency.

- Set up a settlement system between the SDR and other currencies. Therefore, the SDR, which is now only used between governments and international institutions, could become a widely accepted means of payment in international trade and financial transactions.

- Actively promote the use of the SDR in international trade, commodities pricing, investment and corporate book-keeping. This will help enhance the role of the SDR, and will effectively reduce the fluctuation of prices of assets denominated in national currencies and related risks.

- Create financial assets denominated in the SDR to increase its appeal. The introduction of SDR-denominated securities, which is being studied by the IMF, will be a good start.

- Further improve the valuation and allocation of the SDR. The basket of currencies forming the basis for SDR valuation should be expanded to include currencies of all major economies, and the GDP may also be included as a weight. The allocation of the SDR can be shifted from a purely calculation-based system to a system backed by real assets, such as a reserve pool, to further boost market confidence in its value.

IV. Entrusting part of the member countries' reserve to the centralized management of the IMF will not only enhance the international community's ability to address the crisis and maintain the stability of the international monetary and financial system, but also significantly strengthen the role of the SDR. [. . .] ☑

RESERVE CURRENCY NO LONGER. . .

(Continued from page 2)

If Beijing was just talking, or if it was alone in raising the currency concerns, it would be easier for the G7 to divert. But China is not alone. So far these diversification steps have been rather tentative. However, the longer-term concern of those resisting the debate is the prospect of the RMB rising to challenge the pre-eminence of the U.S. dollar.

This would be a ways off. Certainly the Euro and the Japanese yen are further ahead in becoming pre-eminent reserve currencies. But it is not out of the realm of the possible that a more "internationalized" RMB will become a major settlement currency for international trade, a vehicle currency for foreign exchange transactions, and a unit of account for commodities pricing. This reality may be closer in the future than many think.

Despite the reservations expressed by members of the traditional Club of rich powers, at the meeting between the G8 and the G5 emerging powers, China's stand-in representative, State Councilor Dai Bingguo unequivocally raised Beijing's concerns regarding the global currency situation in his presentation to the combined meeting. Though he did not specifically name the dollar, Dai called for the world to consider diversifying the reserve currency system and aim at relatively stable exchange rates. He would have done so looking across the room to the U.S. President and the G8 members who had resisted putting the currency on the agenda.

French President Nicolas Sarkozy gave the proposal a boost from the other side of the table, saying he hoped major industrialized and emerging nations would discuss currency systems when the global economy had largely moved beyond the crisis.

This is the first time that a high-ranking Chinese leader has raised the currency issue in an official speech, at a meeting of the world's top state leaders. Previously, China's ideas for changing the system had only been mentioned in fairly technical reports from the central bank.

And in case anyone was wondering whether Beijing was waffling on the issue, China's foreign ministry spokesperson confirmed at the press briefing after the G8/G5 meeting that this is the "official position" of the Chinese government -- thus overriding earlier attempts from within China's own foreign ministry to downplay the currency debate. Now that the issue has been brought to the fore at a high-level meeting, a precedent has been set. Some type of response from the rich nations would be 'normal'. The cat's out of the bag. Onto the Pittsburgh G20! ☑

Note: This article by Dr. Gregory Chin*, a Senior Fellow of the Centre for International Governance Innovation (CIGI), Toronto first appeared in* GLOBAL PERSPECTIVES*, a joint monthly magazine of* IPS Europe *and the* Global Cooperation Council.