

China's Proposal for a New World Currency

By [Mark Braund](#)

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Fuelling a new world money supply

A paper written ahead of the recent [G20 summit](#) by [Zhou Xiaochuan](#), governor of the Chinese central bank, caused quite a stir. Zhou called for the establishment of a global reserve currency, a step which would firmly tip the balance of economic power in the direction of emerging economies like China and India, but would also bring benefits to poorer nations in the developing world.

Until recently such a suggestion would have been dismissed by the major powers. It's a sign of fundamentally changed times that it's being taken seriously in many quarters, gaining support from India, Russia and Brazil and even an equivocal response from US Treasury Secretary, Tim Geithner.

Two very obvious changes have prompted this reaction: First, there is a growing recognition that the course towards the current crisis was plotted when [President Nixon severed the link between the dollar and gold in 1971](#). Second, the fact that, quite unlike any president before him, not only does Barack Obama believe in a more just and inclusive world, he also seems to recognise that creating such a world requires some levelling of the global economic playing field. The creation of a global reserve currency would be an essential first step in that process.

In his paper, Zhou succinctly defines the qualities of an effective reserve currency: it should be anchored to a stable benchmark; its issue should be subject to clear rules so as to ensure an orderly supply; that supply should be flexible enough to permit adjustment as global demand for money changes; and it not should be linked to the currencies of any particular nation or nations.

Zhou cites Keynes' Bretton Woods proposal for a super-sovereign currency - [the bancor](#) - the value of which, Keynes urged, should be linked to a basket of 30 commodities in order to insulate it from the the economic conditions and policy decisions of individuals nations. Back in 1944, the United States was not prepared to subordinate the dollar to a global currency over which it would have little control. Instead, the world settled for a system under which everyone fixed their exchange rates to the dollar, which was in turn linked to gold. That system lasted nearly three decades; but only now, nearly 40 years after its collapse, is anyone acknowledging the need to replace it.

Currently five currencies - the dollar, the euro, the yen, sterling and the swiss franc act as reserve currencies. But with 65% of global foreign exchange reserves held in dollars, and with China holding more than a \$1tn of these, no wonder the Chinese are getting jumpy. They fear the Obama administration's attempts to spend its way out of recession will erode

the value of their foreign reserves. By switching to a neutral reserve currency before the spectre of inflation raises its head, their hard-earned savings would be protected. But the United States is unlikely to give up its reserve currency status without a struggle because it carries immense economic advantages, not least the capacity to run the kind of budget and current account deficits which would cripple other nations.

Zhou's motivation is not a desire for greater global economic justice. It is, understandably, to protect China's interests at a time when millions of Chinese have yet to experience the benefits of his country's recent economic miracle. Russia's motivation is even more transparent: Dmitry Medvedev suggested that any new reserve currency should be at least partially backed by gold. As one of the world's leading producers of gold, this would put Russia at a distinct advantage.

In the Telegraph, [Ambrose Evans-Pritchard](#) is not persuaded. He believes "the politics of global monetary management would be poisonous". But this misses the point. A reserve currency would only work if there was a widespread commitment to moving the global economy towards one in which co-operation between nations, rather than competition, was the defining feature. If the outcome of efforts to escape global recession is simply a return to business as usual, then a new reserve currency will have no chance.

But even Evans-Pritchard concluded that "10 years hence the picture may look different, a world currency may come into being". That being the case, it should be done properly and for the right reasons. Zhou's suggestion that the [IMF's special drawing rights](#) (SDRs) – a quasi currency established by the IMF in 1969 to try and save the ailing Bretton Woods system – should form the basis of a new reserve currency is unambitious and gives additional power to an institution too closely associated with the Washington consensus that systematically undermined development in the poorer nations.

A better idea comes from the economic philosopher Richard Douthwaite. In his 1999 briefing for [the Schumacher Society, the Ecology of Money](#), he argued that "an international currency should be based on the global resource whose use it is highly desirable to minimise". Today, obviously, that resource is energy. Douthwaite therefore suggests an energy-backed currency unit, or ebcu, as the international reserve currency. His excellent pamphlet can be downloaded for free, [here](#).

His proposal to link the [international monetary system to the need to reduce carbon emissions](#), thus promoting both economic stability and environmental sustainability, is an idea whose time has surely come.

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