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Moveable Multipolarity in Moscow: Ridin' the 'Newcoin' Train

The new currency should be able to become an "external money" storage of capital and reserves down the road, not just a settlement unit.

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Ah, the joys of the Big Circle Line (BKL, in Cyrillic): circumnavigating the whole of Moscow for 71 km and 31 stations: from Tekstilshchiki – in the old textile quarter – to Sokolniki – a suprematist/constructivist gallery (Malevich lives!); from Rizhskaya – with its gorgeous steel arches – to Maryina Roscha – with its 130 meter-long escalator.

The BKL is like a living, breathin', runnin' metaphor of the capital of the multipolar world: a crash course in art, architecture, history, urban design, tech transportation, and of course "people to people's exchanges", to quote our Chinese New Silk Road friends.

President Xi Jinping, by the way, will be ridin' the BKL with President Putin when he comes to Moscow on March 21.

So it's no wonder that when a savvy investor at the top of global financial markets, with decades of experience, agreed to share some of his key insights on the global financial system, I proposed a ride on the BKL – and he immediately accepted it. Let's call him Mr. S. Tzu. This is the minimally edited transcript of our moveable conversation.

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Pepe Escobar (PE)*:* Thank you for finding the time to meet – in such a gorgeous setting. With the current market volatility, it must be hard for you to step away from the screens.

S. Tzu: Yes, markets are currently very challenging. The last few months remind me of 2007-8, except instead of money-market funds and subprime mortgages, these days it is pipelines and government bond markets that blow up. We live in interesting times.

PE: The reason I reached out to you is to hear your insights on the "Bretton Woods 3" concept introduced by Zoltan Poszar. You're definitely on top of it.

S. Tzu: Thank you for getting straight to the point. There are very few opportunities to witness the emergence of a new global financial order, and we are living through one of those episodes. Since the 1970s, perhaps only the arrival of bitcoin just over fourteen years ago came close in terms of impact to what we are about to see in the next few years. And just as the timing of bitcoin was not a coincidence, the conditions for the current tectonic shifts in the world financial system have been brewing for decades. Zoltan's insight that "after this war is over, 'money' will never be the same again…" was perfectly timed.

Understanding "external money"

PE: You mentioned bitcoin. What was so revolutionary about it at the time?

S. Tzu: If we leave aside the crypto side of things, the promise and the reason for bitcoin's initial success was that bitcoin was an attempt to create "external" money (using Mr. Zoltan's excellent terminology) that was not a liability of a Central Bank. One of the key features of this new unit was the limit of 21 million coins that could be mined, which resonated well with those who could see the problems of the current system. It sounds trivial today, but the idea that a modern monetary unit can exist without backing of any centralized authority, effectively becoming "external" money in digital form, was revolutionary in 2008. Needless to say, Euro government bond crisis, quantitative easing, and the recent global inflationary spiral only amplified the dissonance that many felt for decades. The credibility of the current "internal money" system (again, using Mr. Poszar's elegant terminology) has been destroyed long before we got to the Central Bank reserve freezes and disruptive economic sanctions that are playing out currently. Unfortunately, there is no better way to destroy credibility of the system based on trust than to freeze and confiscate foreign currency reserves held in Central Bank custody accounts. The cognitive dissonance behind the creation of bitcoin was validated — the "internal money" system was fully weaponized in 2022. The implications are profound.

PE: Now we are getting to the nitty-gritty. As you know, Zoltan argues that a new "Bretton Woods 3" system will emerge at the next stage. What exactly does he mean by that?

S. Tzu: I am also not clear on whether Mr. Poszar refers to the transformation of the current Western "internal money" system into something else, or whether he hints at the emergence of the "Bretton Woods 3" as an alternative, outside of the current financial system. I am convinced that a new iteration of the "external money" is unlikely to be successful in the West at this stage, due to the lack of political will and to the excessive government debt that has been building up for some time and grew exponentially in recent years.

Before the current Western financial order can move to the next evolutionary stage, some of these outstanding liabilities need to be reduced in real terms. If history is any guide, it typically happens via default or inflation, or some combination of the two. What seems highly likely is that the Western governments will rely on financial repression in order to keep the boat afloat and to tackle the debt problem. I expect there will be many initiatives to increase control over the "internal money" system that will likely be increasingly unpopular. Introduction of CDBC's, for example, could be one such initiative. There is no doubt in my mind that we are in for eventful times ahead in this respect. At the same time, it also seems inevitable at this stage that some sort of an alternative "external money" system will emerge that will compete with the current "internal money" global financial order.

PE: And why is that?

S. Tzu: The global economy can no longer rely on the "internal money" system in its current weaponized state for all its trade, reserve, and investment needs. If sanctions and reserve freezes are the new instruments of regime change, every government out there must be thinking about alternatives to using someone else's currency for trade and reserves. What is not obvious, however, is what the alternative to the current flawed global financial order should be. History does not have many examples of successful "external money" approaches that could not be reduced to some version of the gold standard. And there are many reasons why gold alone, or a currency fully convertible into gold, is too restrictive as a foundation of a modern monetary system.

At the same time, recent increases in trade in local currencies unfortunately have a limited potential as well, as local currencies are simply a different instance of "internal money." There are obvious reasons why many countries would not want to accept other's local currencies (or even their own, for that matter) in exchange for exports. On that I fully agree with Michael Hudson. Since "internal money" is a liability of a country's Central Bank, the lower the credit standing of the country, the more it needs investable capital, and the less willing other parties become to hold its liabilities. That is one of the reasons why a typical set of "structural reforms" that IMF demands, for example, is aimed at improving credit quality of the borrower government. "External money" is badly needed precisely by the countries and the governments that feel they are hostages to the IMF and to the current "internal money" financial system.

Enter the "newcoin"

PE: A lot of experts seem to be looking into it. Sergey Glazyev, for instance.

S. Tzu: Yes, there were some indications of that in recent publications. While I am not privy to these discussions, I certainly have been thinking how this alternative system could work as well. Mr. Pozsar's concepts of "internal" and "external" money are a very important part of this discussion. However, the duality of these terms is misleading. Neither option is fully adequate for the problems that the new monetary unit – let's call it "newcoin" for convenience – needs to solve.

Please allow me to explain. With the weaponization of the current US dollar "internal money" system and a simultaneous escalation of sanctions, the world has effectively split into the "Global South" and the "Global North," slightly more precise terms than East and West. What is important here, and what Mr. Pozsar immediately noticed, is that the supply chains and commodities are also getting weaponized to some extent. Friend-shoring is here to stay. The implication is that the newcoin's first priority would be facilitating intra-South trade, without relying on currencies of the Global North.

If this were the only objective, there would have been a choice of relatively simple solutions, ranging from using renminbi/yuan for trade, creating a new shared currency (fashioned after euro, ECU, or even Central African CFA franc), creating a new currency based on the basket of participating local currencies (similar to the SDR of IMF), potentially creating a new gold-pegged currency, or even pegging existing local currencies to gold. Unfortunately, history is full of examples of how each one of these approaches creates their own host of new problems.

Of course, there are other parallel objectives for the new currency unit that neither of these possibilities can fully address. For example, I expect that all participants would hope that the new currency strengthens their sovereignty, not dilutes it. Next, the challenges with the Euro and previously gold standard demonstrated the broader problem with “fixed” exchange rates, especially if the initial “fix” was not optimal for some members of the currency zone. The problems only accumulate over time, until the rate is “re-fixed,” often through a violent devaluation. There needs to remain flexibility in adjusting relative competitiveness inside the Global South over time for participants to remain sovereign in their monetary decisions. Another requirement would be that the new currency needs to be “stable,” if it were to become successful unit of pricing for volatile things like commodities.

Most importantly, the new currency should be able to become an “external money” storage of capital and reserves down the road, not just a settlement unit. In fact, my conviction that the new monetary unit will emerge comes primarily from the current lack of viable alternatives for reserves and investment outside of the compromised “internal money” financial system.

PE: So considering all these problems, what do you propose as a solution?

S. Tzu: First allow me to state the obvious: the technical solution to this problem is a lot easier to find than to arrive at the political consensus among the countries which might want to join the newcoin zone. However, the current need is so acute, in my opinion, that the required political compromises will be found in due course.

That said, please allow me to introduce one such technical blueprint for the newcoin. Let me start by saying that it should be partially (I suggest a share of at least 40% of value) backed by gold, for reasons that will soon become clear. The remaining 60% of the newcoin would be composed of the basket of currencies of the participating countries. Gold would provide the “external money” anchor to the structure and the basket of currencies element would allow the participants to retain their sovereignty and monetary flexibility. There would clearly be a need to create a Central Bank for the newcoin, which would emit new currency. This Central Bank could become a counterparty to cross-swaps, as well as provide clearing functions for the system and enforce the regulations. Any country would be free to join the newcoin on several conditions.

First, the candidate country needs to demonstrate that it has physical unencumbered gold in its domestic storage and pledge a certain amount in exchange for receiving corresponding amount of newcoin (using the 40% ratio mentioned above). Economic equivalent of this initial transaction would be a sale of the gold to the “gold pool” backing the newcoin in exchange for proportional amount of the newcoin backed by the pool. The actual legal form of this transaction is less important, as it is necessary simply to guarantee that the newcoin that is being emitted is always backed by at least 40% in gold. There is no need to even publicly disclose the gold reserves of each country, as long as all participants can be satisfied that sufficient reserves are always present. An annual joint audit and monitoring mechanism may be sufficient.

Second, a candidate country would need to establish a gold price discovery mechanism in its domestic currency. Most likely, one of the participating precious metals exchanges would start physical gold trading in each of the local currencies. This would establish a fair cross-rate for the local currencies using "external money" mechanism to set and adjust them over time. The gold price of the local currencies would drive their value in the basket for the newly-emitted newcoins. Each country would remain sovereign and be free to emit as much of local currency as they choose to, but this would eventually adjust the share of their currency in the newcoin's value. At the same time, a country would only be able to obtain additional newcoin from the central bank in exchange for a pledge of additional gold. The net result is that the value of each component of newcoin in gold terms would be transparent and fair, which would translate into the transparency of newcoin's value as well.

Finally, emissions or sales of newcoin by the central bank would be allowed only in exchange for gold for anyone outside the newcoin zone. In other words, the only two ways external parties can obtain large amounts of newcoin is either receiving it in exchange for physical gold or as a payment for goods and services provided. At the same time, the central bank would not be obliged to purchase newcoin in exchange for gold, removing the risk of the "run on the bank."

PE: Correct me if I'm wrong: this proposal seems to anchor all trade inside the newcoin zone and all external trade to gold. In this case, what about the stability of newcoin? After all, gold has been volatile in the past.

S. Tzu: I think what you are asking is what could be the impact if, for example, the dollar price of gold were to decline dramatically. In this case, as there would be no direct cross-rate between newcoin and the dollar, and as the central bank of the Global South would be only buying, not selling gold in exchange for newcoin, you can immediately see that arbitrage would be extremely difficult. As a result, the volatility of the currency basket expressed in newcoin (or gold) would be quite low. And this is exactly the intended positive impact of the "external money" anchoring of this new currency unit on trade and investment. Clearly, some key export commodities would be priced by the Global South in gold and newcoin only, making the "run on the bank" or speculative attacks on newcoin even less likely.

Over time, if gold is undervalued in the Global North, it would gradually, or perhaps rapidly, gravitate to the Global South in exchange for exports or newcoin, which would not be a bad outcome for the "external money" system and accelerate the broad acceptance of newcoin as reserve currency. Importantly, as physical gold reserves are finite outside of the newcoin zone, the imbalances would inevitably correct themselves, as the Global South will remain a net exporter of key commodities.

PE: What you just said is packed with precious info. Perhaps we should revisit the whole thing in the near future and discuss the feedback to your ideas. Now we've arrived at Maryina Roscha, it's time to get off!

S. Tzu: It would be my pleasure to continue our dialogue. Looking forward to another loop!

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