What China's Push for An Alternative World Reserve Currency Means

By Washington's Blog

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Yesterday, after China called for a super-sovereign currency, the dollar slid as investors started seeing the writing on the wall. Specifically, the People's Bank of China said the International Monetary Fund should manage part of members' foreign-exchange reserves. See this.

"To prevent the deficiencies in the main reserve currency, there's a need to create a new currency that's delinked from the economies of the issuers," the People's Bank of China (PBOC) said in a review of the economy in 2008 released today. In March, the PBOC had urged the IMF to expand operations of its Special Drawing Rights currency (SDRs) and move toward a "super-sovereign reserve currency."

The PBOC argues that the frequency and intensity of financial crises following the collapse of the Bretton Woods system suggests costs of the dollar-based system may have exceeded its benefits and that that the SDR could take on a key global role.

The PBOC statement comes a day after a top Communist Party research chief said that China should buy gold and U.S. real estate rather than Treasurys.

American officials and talking heads have attempted to downplay the irreversible trend of the dollar fading as the world's reserve currency. They have argued that China is in a dollar trap. With trillions in dollars, they argue, China cannot let the dollar tank.

But as Marc Faber has pointed out, 2 trillion dollars in reserves isn't really that much for a country with as many people as China has. And China long ago signaled that it was gradually moving out of dollars. The signals came in the form of (1) China moving out of long treasuries and into treasuries with a duration of 3 years or less, and (2) China using its reserves to buy commodities, instead of more dollars.

Nouriel Roubini argues:

> The process that will lead – in the medium-long term – to a challenge of the US dollar as the major global reserve currency has started. The US creditors – the BRICs, the Gulf states and others – are becoming increasingly alarmed that the US will deal with its unsustainable fiscal path via inflation and debasement of the value of the dollar via depreciation. So they will not sit idly waiting for this to happen: they are already diversifying into gold, into resources (as China purchases mines and energy, mineral and commodity resources all over the world).

And the senior economist at the Federal Reserve Bank of Cleveland argued last month:

> While SDRs may be declared an official international reserve asset today, they are not likely to become the world's key international currency anytime soon.

In other words, as explained by Nouriel Roubini, the Fed economist he believes that the SDR may be declared the world reserve currency, but the current usefulness of the dollar as a highly liquid, international medium of exchange means that it won't be replaced in the near future as the key unit of international trade.

Would the SDR be a Better Reserve Currency than the Dollar?

Given the IMF's history of imposing draconian, destructive and anti-democratic measures on third world countries, I'm not sure that appointing the IMF as the issuer of the world reserve currency is a great idea.

But to understand the big picture on SDRs, dollars and other potential reserve currencies and mediums of exchange, we have to take a step back and look at what money really is.

It should be remembered that money does not itself have to be a valuable commodity. Obviously, gold is a valuable commodity and can serve as money. And, in many ways, having a gold-backed currency is better than having a fiat currency.

But in its most essential form, currency is solely a way to keep track of the exchange of goods and services. In other words, money is simply a way of keeping tally, a scoreboard, a record keeping system.

As such, money could be pegged to just about anything objective, such as the consumer price index (as long as it included food and energy) or – as China has proposed – a basket of 30 or so commodities.

In fact, there is no need for the U.S. or any other country to cede its sovereignty to a group of international bankers. On the other hand, there is no need for the rest of the world to be beholden to the dictatorial one-sidedness inherent in using the dollar as the world's reserve currency.

Instead, money can be returned to its most minimalist function of being a neutral yardstick to measure goods and services exchanged. In other words, instead of being an instrument of financial warfare and oppression, money can return to its function simply as an objective tally of who owes who what for the good and services they have provided.

As Ellen Brown explains in her book Web of Debt (as summarized by Stephen Lendman):

A global currency is another proposal – one that creates more problems than it solves. The world "is not one nation or one region," and who's to be boss and in charge. Further, if all governments issued the same currency, "the global money supply (would be) vulnerable to irresponsible governments (issuing) too much." Strong ones would end up dominating the weak, and national sovereignty would be weakened, perhaps ended. A "fully dollarized" world is a prescription for trouble enough to make scarcity "the order of the day."

Rather than one currency, "a single global yardstick" is needed "against which governments can value their currencies – some independent measure (by) which merchants can negotiate their contracts and be sure of getting what they bargained for"…

National currencies "would become what (they) should have been all along – (contracts) or promise(s) to return value in goods and services of a certain worth, as measured against a universally recognized yardstick for determining value."

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