

Commentary

APRIL 2009

BUFFIN PARTNERS INC.

ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

New Focus on Role of Global Reserve Currency

Governor Zhou Xiaochuan, Chairman of the Monetary Policy Committee of the People's Bank of China, spoke recently on *Reform the International Monetary System*. His speech represented an appeal to address the question of what kind of international reserve currency is needed to secure global financial stability and facilitate world economic growth. The characteristics of an international reserve currency, according to Zhou Xiaochuan, should include being anchored to a stable benchmark, and issued according to a clear set of rules, with its supply flexible enough to allow timely adjustment according to changing demand, and that such adjustments should be disconnected from economic conditions and sovereign interests of any single country. He stated that the desired goal of reforming the international monetary system is to create an international reserve currency that is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies. Zhou Xiaochuan also referred to the history of various proposals for a super-sovereign reserve currency including the "bancor" developed by John Maynard Keynes, the eminent British economist, based on a composite of thirty commodities including gold.

In the October 2008 edition of *Commentary* under the title *Après Dégringolade* we wrote: "It appears that the SDR will become more widely known as concerns about the role of the US dollar in the international monetary system gain the attention of the world's leading economists. It is possible to envision a scenario where the SDR serves as a model for replacing the US dollar as an international reserve currency and for pricing commodities and various international contracts with an SDR-like virtual global currency. The SDR (*Special Drawing Rights*) is an international reserve asset,

created by the IMF to supplement the existing official reserves of IMF member countries. The SDR is denominated as a composite basket of four currencies comprising the US Dollar, European Euro, Japanese Yen and British Pound; the US dollar has a 44% weighting in the SDR; the other three currencies have a combined weighting of 56%."

In the December 2008 edition of *Commentary* under the title *G20 Declaration on Financial Markets and World Economy* we wrote: "Concerning reform of International Financial Institutions, including the International Monetary Fund (IMF), the G20 declaration committed to the reform of the Bretton Woods Institutions to more adequately reflect changing economic influence in the world economy and increase their legitimacy and effectiveness. The declaration stated that emerging and developing economies should have greater representation. It also appealed for the IMF and other bodies to better identify vulnerabilities, anticipate potential stresses, and act swiftly to play a key role in crisis response."

In the March 2009 edition of *Commentary* under the title *Geopolitical Implications of the Financial Crisis* we wrote: "It is now widely accepted that the leadership and influence of the United States and Europe have been adversely affected in geopolitical terms by the economic and financial crisis. As the power and influence of the United States and Europe decline, other economic powers are gaining in stature and influence, most notably China, with its estimated foreign exchange reserves of around \$2 trillion. China is also expected to increase the capital base of the IMF and extend its own influence on the direction of future activities of the IMF. The global economic and financial crisis calls into question the ability of the IMF and other Bretton Woods

organizations to respond effectively to events before they develop into a systemic meltdown. There is evidence of a nascent campaign for significant reforms to be made to these organizations. Their suitability to continue to serve in their present form as major players in the new global economic environment is being challenged on many fronts. Many experts believe that they require significant reforms if they are to function in the best interests of all nations for global economic and financial stability."

Zhou Xiaochuan recommended that special consideration be given to a greater role for the SDR since the SDR has the features and potential to act as a super-sovereign reserve currency. He also advocated the active promotion of the use of the SDR in international trade and commodities pricing, the creation of financial assets denominated in SDR, and the introduction of SDR-denominated securities. Another recommendation that he made was to further improve the valuation and allocation of the SDR; the basket of currencies forming the basis of the SDR valuation should be expanded to include currencies of all major economies, with their respective GDP measures used as weightings. Entrusting part of member countries' reserves to the centralized management of the IMF would 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.

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