

On the future of the world monetary system

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International monetary system (I)

“The global crisis resurrected deep-rooted concerns about the functioning of the international monetary system (IMS). Despite its relative stability, the current “non-system” has the inherent weaknesses of a setup with a dominant country-issued reserve currency, wherein the reserve issuer runs fiscal and external deficits to meet growing world demand for reserve assets and where there is no ready mechanism forcing surplus or reserve-issuing countries to adjust.”

—KDI/IMF Conference on Reconstructing the World Economy, February 25, 2010, Seoul, Korea, <http://www.imf.org/external/np/seminars/eng/2010/kdi/pdf/ims.pdf>



Conference of Bretton Woods, July 1944

International monetary system (II)



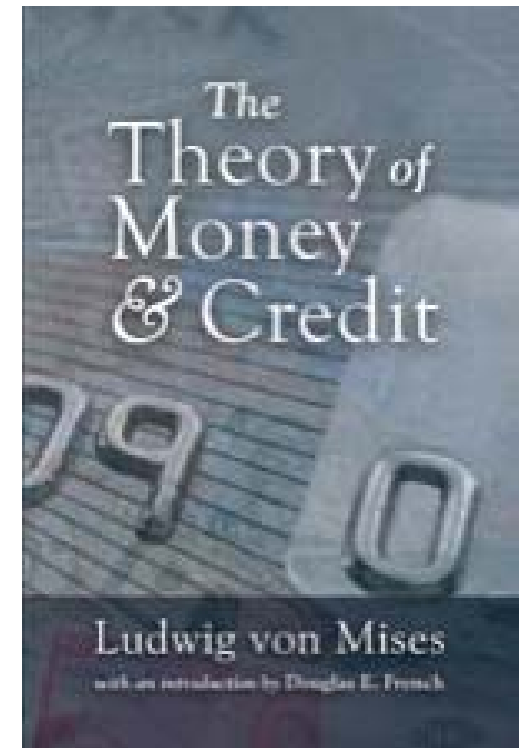
“(...) a world monetary system has emerged that has no historical precedent: a system in which every major currency in the world is ... on an irredeemable paper money standard (...).

The ultimate consequences of this development are shrouded in uncertainty.”

Friedman, M. (1992), Money Mischief: Episodes in Monetary History, Harcourt Brace Jovanovich, New York, 1992, pp. 249, 252 – 4.

Money: nature and function(s)

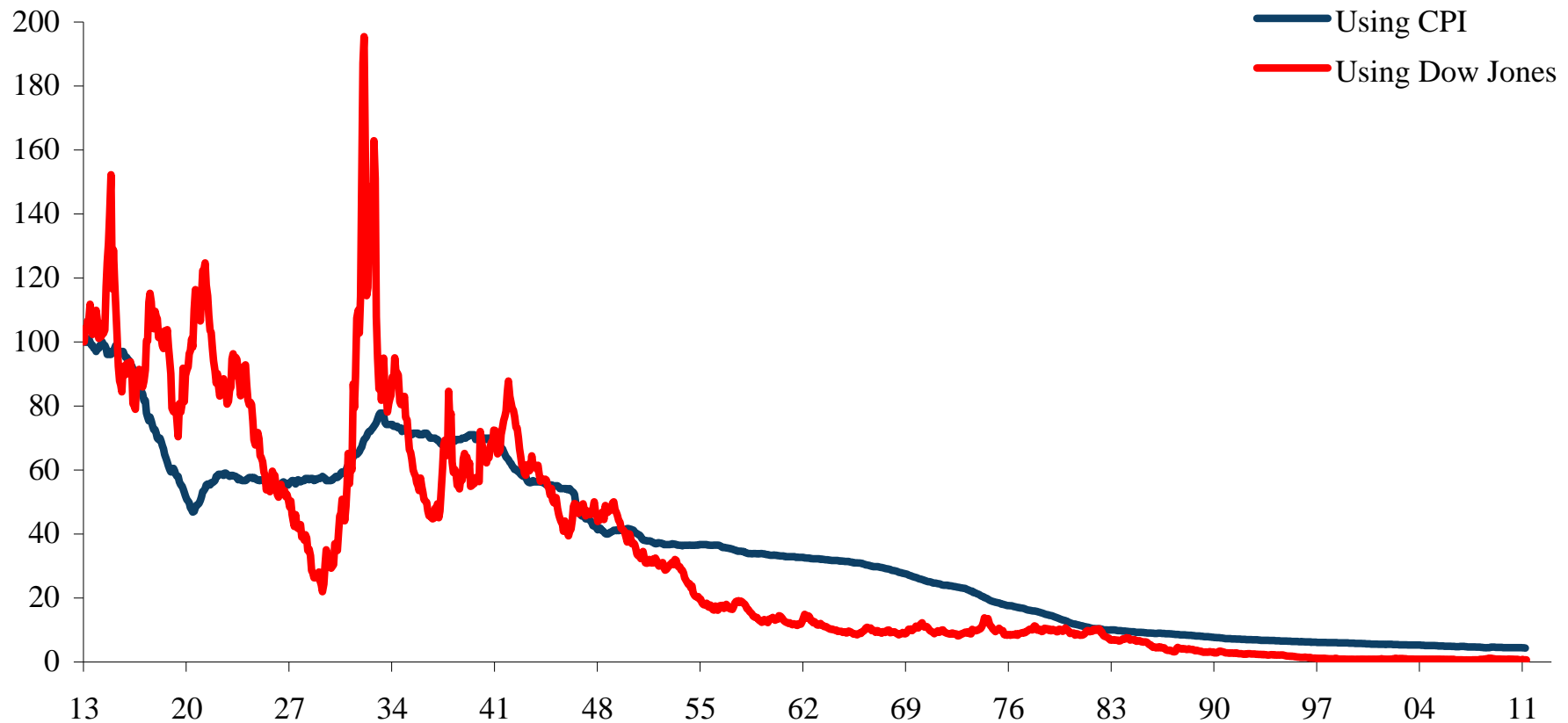
- Money is the *universally accepted means of exchange*
- Money's sole function is the *means of exchange function*
- Money must fulfil certain *requirements*. It must be: *scarce, relatively stable (as far as its purchasing power is concerned), homogeneous, durable, divisible, transportable, mintable etc.*



The purchasing power of (fiat) money

Purchasing power of the US dollar 1913 to 2011

on the basis of the US CPI and the Dow Jones stock market index



Source: Bloomberg, own calculations.

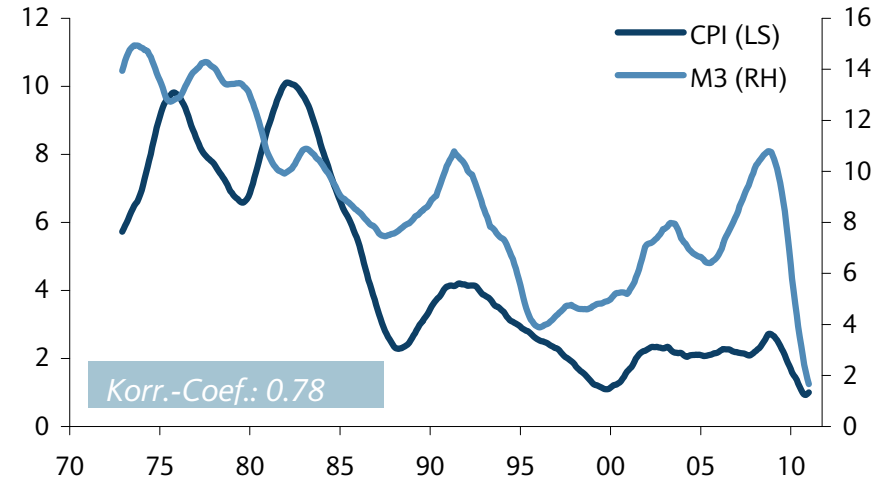
Series are indexed (January 1913 = 100).

Money and CPI inflation in the euro area

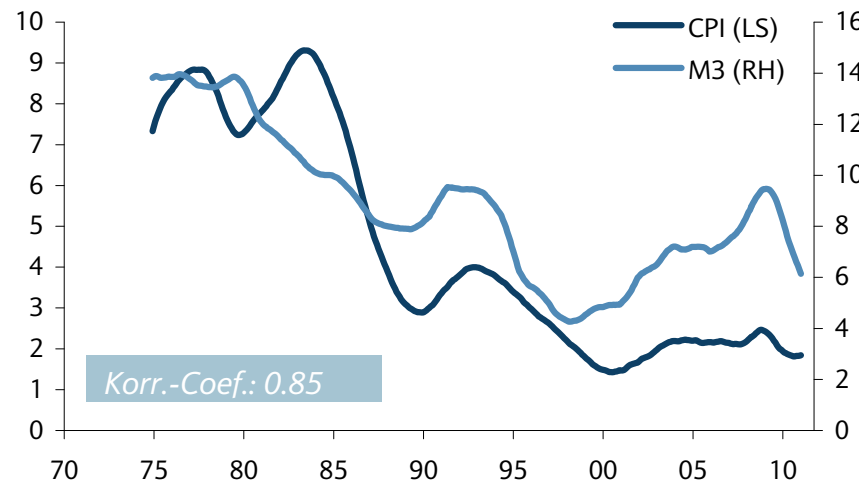
(a) Co-temporaneous (% y/y)



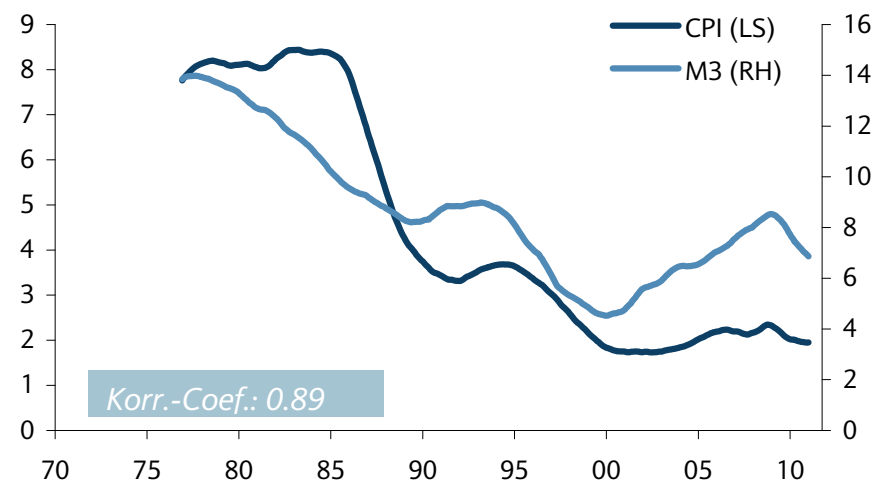
(b) 2-years gliding average (% y/y)



(c) 4-years gliding average (% y/y)



(d) 6-years gliding average (% y/y)



Source: Thomson Financial, own calculations.

Commodity versus fiat money

- Carl Menger (1840 – 1914) explained in 1871 that money emerged *spontaneously* from the free market.
- Ludwig von Mises (1881 – 1973) showed in 1912 with his *regression theorem* that money *must* have emerged from a (non-monetary) commodity.
- *Fiat money* in the form of paper and/or “bits and bytes” has never been introduced by free market forces but only through government coercion (Hülsmann, 2007).

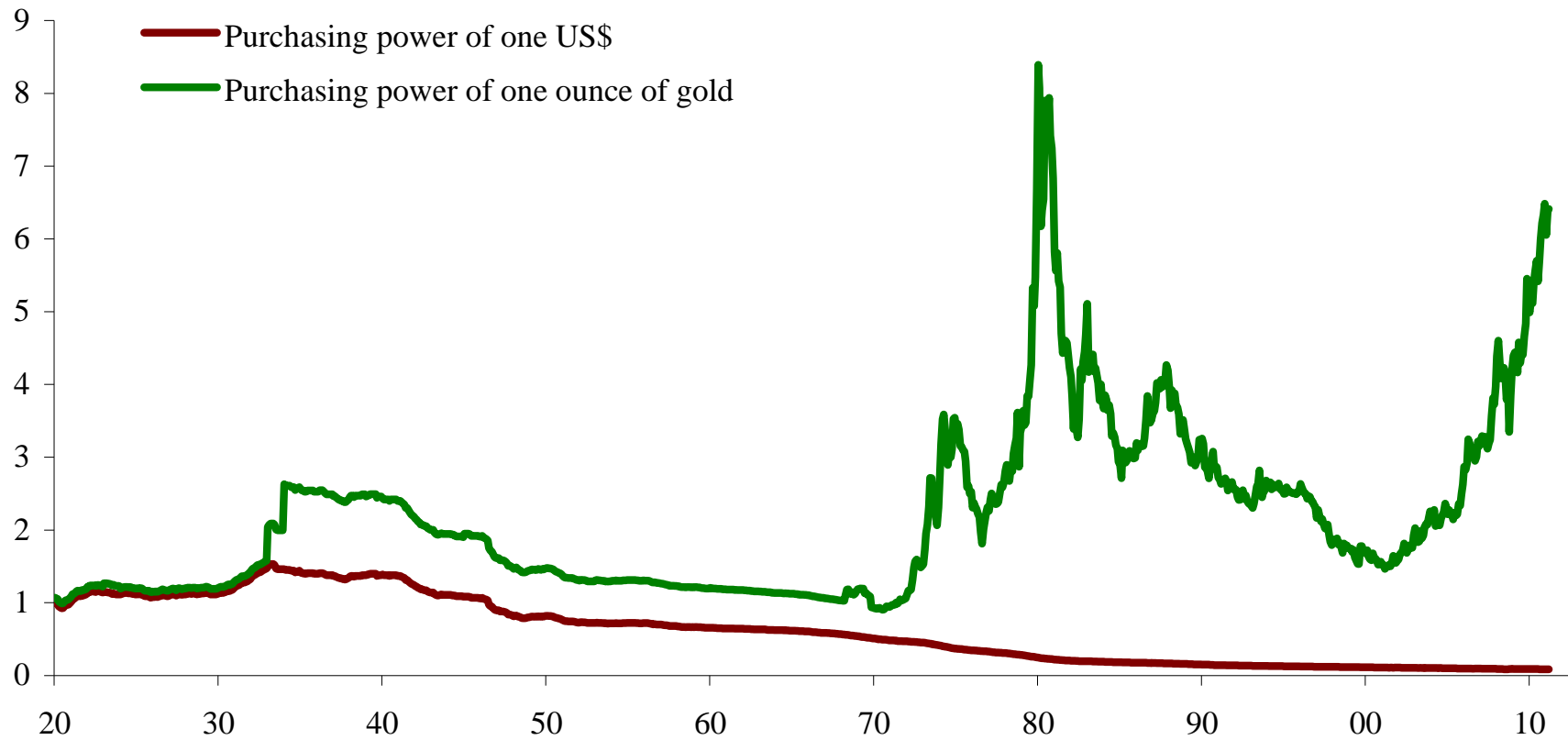
→ *The closing of the gold window on 15 August 1971 by US President R Nixon.*



*Carl Menger
1840 – 1914*

The purchasing power of gold

Purchasing power of one US\$ and one ounce of gold (on the basis of the US CPI)



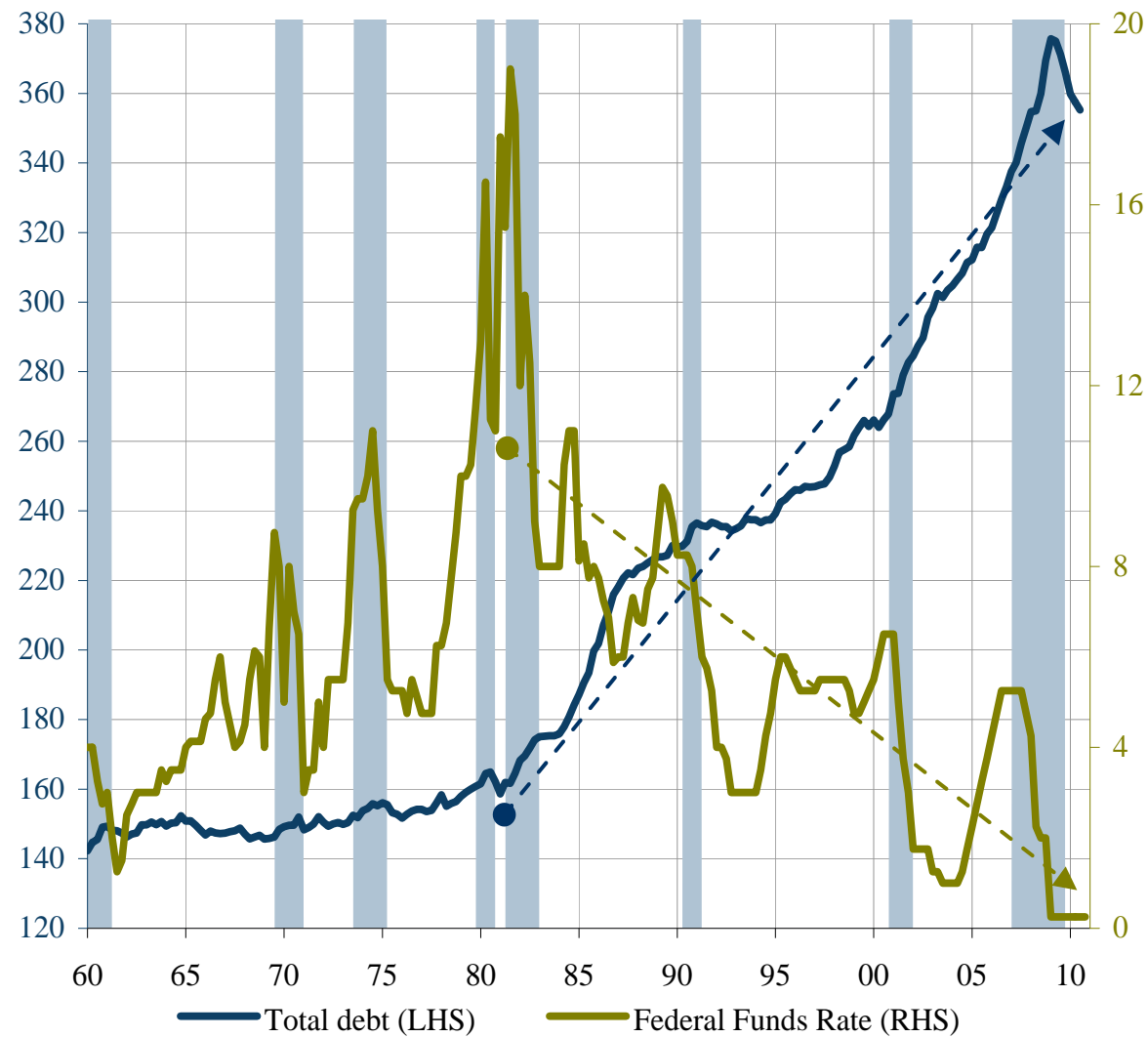
Source: Bloomberg, own calculation.

A brief history

- Phase I: 1816 – 1914, The *classical gold standard*
- Phase II: World War I and shortly thereafter
- Phase III: 1926 – 1931, The *gold-exchange standard*
- Phase IV: 1931 – 1945, fluctuating fiat currencies
- Phase V: 1945 – 1968, the *System of Bretton Woods*
- Phase VI: 1968 – 1971, the demise of the System of Bretton Woods
- Phase VII: As from August 1971, fiat money system

US debt and rates

US total debt level in % of GDP and Federal Funds Rate (%)



Source : Thomson Financial, own calculations. Shaded areas represent recession periods according to NBER. Effective Federal Funds Rate up to 1971-Q1, thereafter target rate.

China on the international monetary system



“The desirable goal of reforming the international monetary system ... 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.**”

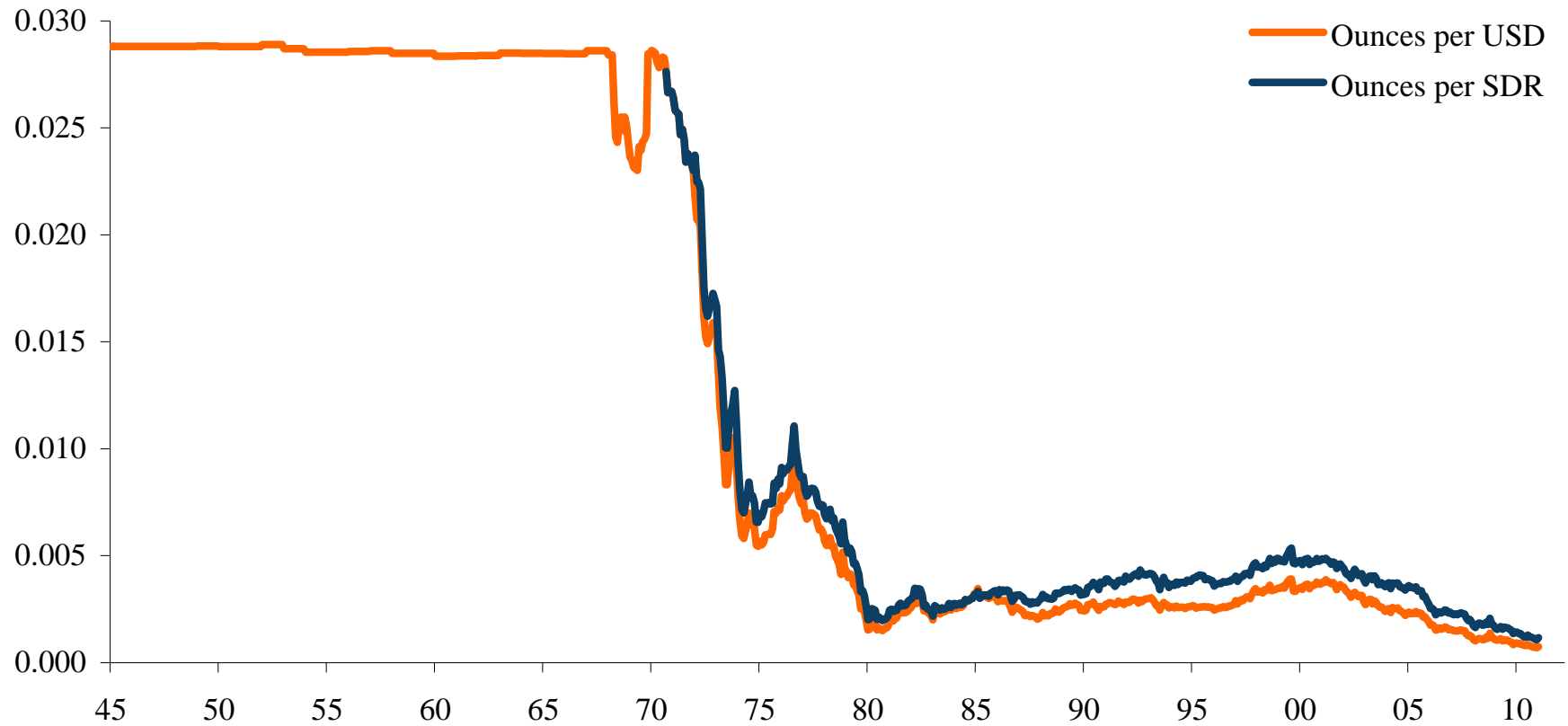
“Back in the 1940s, Keynes had already proposed to introduce an international currency unit named “Bancor”, based on the value of **30 representative commodities.**”

“The creation of an international currency unit, based on the **Keynesian proposal**, is a bold initiative that requires extraordinary political vision and courage.”

Source: Zhou Xiaochuan, Governor of The Peoples' Bank of China, Reform the International Monetary System, 23 March 2009.

Special Drawing Rights

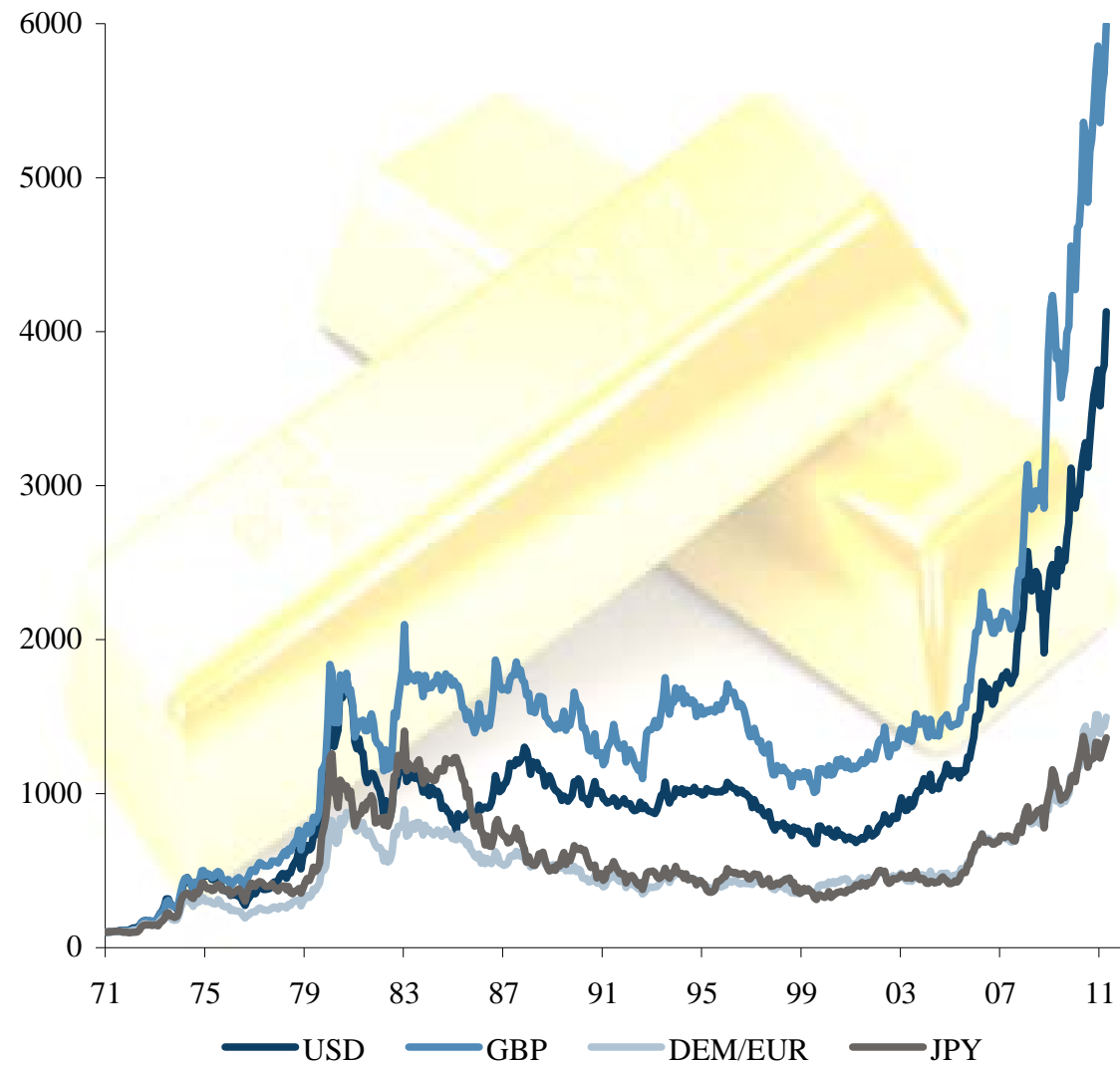
Gold ounces per USD and Special drawing rights (SDR)



Source: Bloomberg, own calculation.

Gold price

Price of one ounce of gold in national currencies

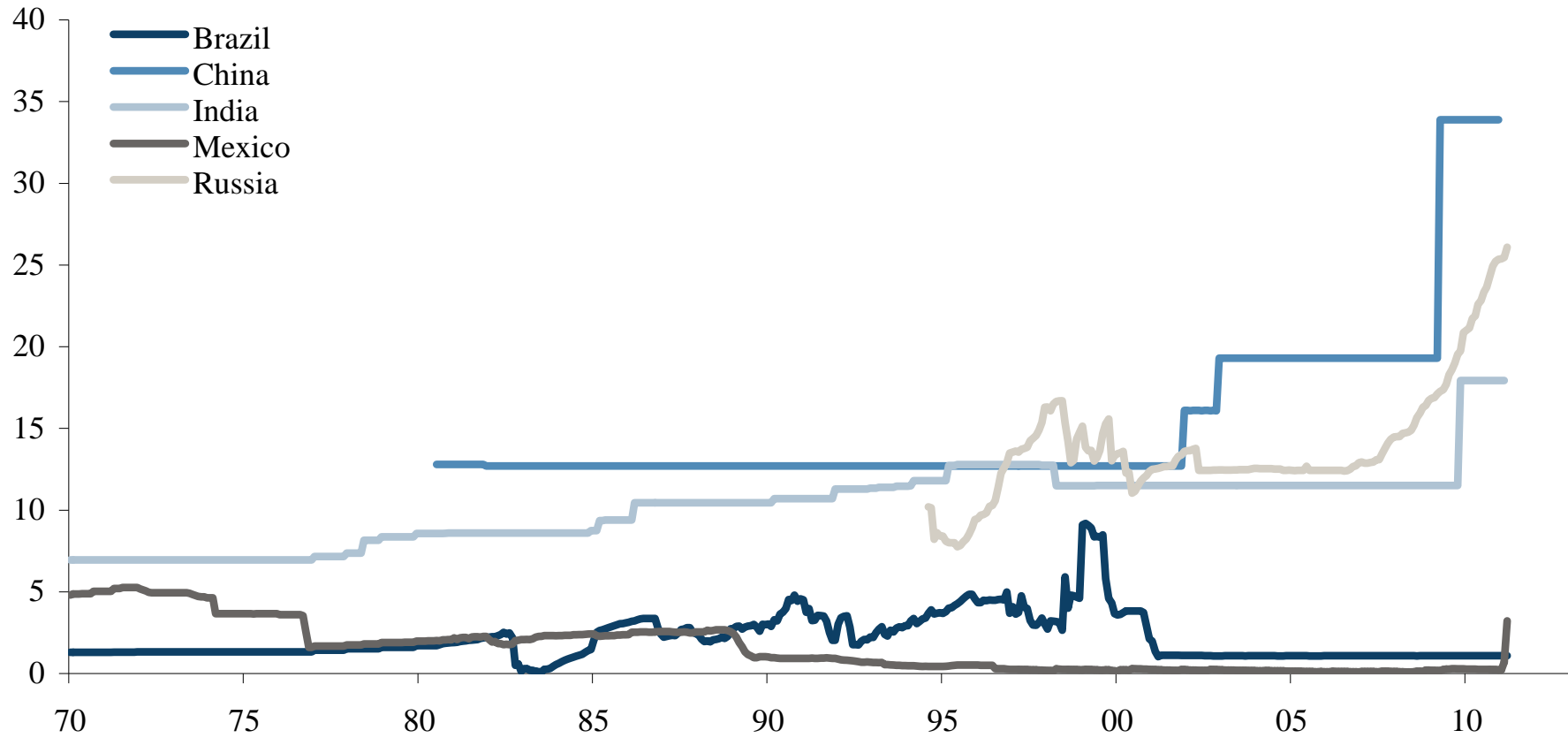


Source: Bloomberg, own calculations.

Series are index (Jan '71 = 100).

Official gold reserves

Official gold reserves, ounces mn



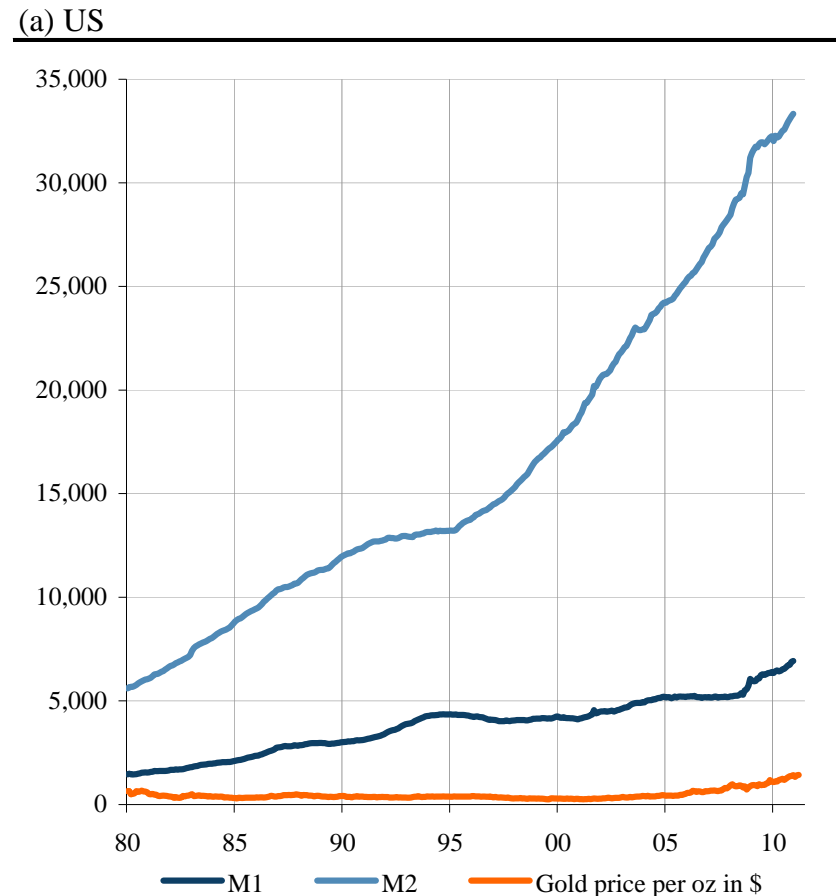
Source: IMF, Bloomberg.

On the role of gold

„No other currency, national or international, can conceivably take the place of the American dollar. They all suffer seriously from the same ideological malady: they are the creation of political concern and authority. Whatever we may think of gold, it always looms in the background, beckoning to be used as money, as it has been since the dawn of civilization.“

—Sennholz, H. F. (2003), Why Gold? Mises Daily Articles.

Gold price, US\$ per oz, 100% cover ratio of outstanding money supply measures*



Source: Thomson Financial, own calculations.

*Money supply stock divided by official central bank gold reserves.