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Global Imbalances and the Key Currency Regime: The Case for a Commodity Reserve Currency

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Abstract

This paper considers Kaldor's 1964 proposal for a commodity reserve currency (CRC) as a serious alternative to the current system, which has the US dollar as the world reserve currency. It argues that the reserve-currency status of the US dollar helped to create global imbalances and financial fragility pre-empting the current crisis. The primary goal of the CRC was to resolve the 1960 Triffin dilemma, which remains a problem today. Following a brief history of alternative monetary reform proposals, the CRC is outlined. Backed by a basket of 30 or so commodities, the CRC would fix their price index in terms of the international reserve and reduce the disorderly swings in individual commodity prices. Sovereign governments would be free to fix or float their national currencies to the CRC. With growing fears over global warming and national resource security, particularly in the world's poorest countries, the introduction of a CRC

could reduce supply constraints, stabilize costs of production, promote global effective demand from the periphery and balance growth between periphery and core countries.

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Notes

[1]Other variants of this scheme were proposed by Frank Graham (see Endres, 2005, pp. 85–93), and F.A. Hayek (1943).

[2]As the outflow of private long-term capital and government grants and capital transactions exceeded the US surplus in the balance on current account, the basic balance would be in deficit. This was financed by a fall in the US gold stock and an increase in the foreign holdings of dollar assets. Confidence that the US could continue to redeem dollar holdings in gold began to wane. In 1971 the US defaulted on this commitment when Nixon closed the gold window and made the dollar inconvertible into gold.

[3]For a discussion of the distinction between these two multipliers, see McCombie (1985).

[4]Devaluation is effective only when it does not lead to retaliation by others in a global sense.

[5]Williams (1943) argued that even under the gold standard, it was the strength of sterling at the height of the British Empire combined with Britain's accommodations with the periphery countries that stabilized the currency regime.

[6]A complete bibliography of commodity buffer stocks and a commodity reserve currency can be found at http://bufferstock.org/biblio.htm.

[7]Kaldor believed that every country in the European Community could improve its situation if the Common Agricultural Policy was taken out of its fiscal framework and instead financed by newly printed money, which would be accepted by a European Central Bank as a reserve against commodities (Kaldor, 1996, p. 109).

[8]Kaldor drafted the text (Hart, 1991, p. 562); Tinbergen was primarily a signatory (Toye & Toye, 2004, p. 221).

[9]Similarly, the World Bank (2009, p. 130) recently estimated that an international stockpile to stabilize international grain prices would require 10% of global production, worth roughly $66 billion, and cost $4–6 billion to maintain ($1.4 billion in storage costs and $3–5 billion of spoilage costs based on losses in high-income countries). Total losses to all consumers from rising food prices in 2007 were estimated at $270 billion (ibid., p. 127).

[10]Indeed such a plan may provide a resolution to the Doha round of WTO negotiations by neutralizing the ability of developed country subsidies to depress world prices.

[11]The operation of the CRC would differ sharply between the initial build up period and the ensuing operation period; see Hart et al. (1964) for more details.

[12]Hart et al. proposed an initial fiduciary issue of $5 billion and a separate $5 billion bancor issue in exchange for gold, creating a bimetallic bancor standard. The assets that are attained in exchange for bancor that are not commodities could be used by the ICF to pay for storage facilities.

[13]Kaldor used this term to characterize the commodity reserve currency in a letter to Sidney Dell, 23 March 1963, cited in Toye & Toye (2004, p. 221).

[14]Kaldor's recognition of procyclicality in commodity markets goes back to his 1934 microeconomic cobweb theory of fixed quantities and flexible prices with production lags. The extension to the macro-economy and global levels with primary and secondary markets made income and effective demand in the developed world the important variable.

[15]Hart (1976) proposed a 10% spread between the bid and ask prices at which the ICF stands ready to buy or sell. For example, if the designated basket unit is priced at B$ 1,000,000 bancor units, the ICF would be ready to buy additional basket units at B$ 950,000 or ready to sell basket units at B$ 1,050,000.

[16]Hart et al. (1964, p. 157) did propose a penalty on countries that deliberately keep their currency low by selling their currency and accumulating reserves at an unduly fast rate; for example, an import blockade, as under the scarce currency clause.

[17]While Kaldor had grown skeptical of the political viability of a CRC by the early 1980s, and gravitated toward simpler individual commodity buffer stock schemes (see Kaldor, 1983, p. 548), he was no less convinced of the social and economic merits of a CRC.

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