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ALTERNATIVE INTERNATIONAL CURRENCIES

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ABSTRACT: *The modern international monetary system has a number of flaws and therefore needs cardinal change. Hence, economists from all over the world are suggesting alternative international currencies that would make the international monetary system more efficient. However, it is essential when approaching the creation of a new international currency to analyse and take into account the experience of all the past international currencies. Therefore this paper begins with an exploration of the drawbacks of each of the past and present*

international currencies. Drawing on this analysis a justification will be made for the necessity of introducing a new international currency, pointing to the requirements it should meet. Further on, this paper proposes an alternative theoretically possible variant of the international currency, with a fixed value relative to a commodity basket. An abstract example is used to demonstrate its composition and circulation mechanism.

KEY WORDS: *international monetary systems, currency clearing, balance of payments, supranational currency*

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1. INTRODUCTION

The modern international monetary system has a number of shortcomings, and therefore requires cardinal change. This issue is becoming increasingly acute. Economists from all over the world are suggesting various ways of creating alternative international currencies that would make the international monetary system more efficient. The usage of the national currencies the dollar and the euro as the key international currencies presents a number of drawbacks. This leads many scholars towards favouring the idea of supranational currencies.

The idea of creating supranational currencies is not new. Among early works discussing the introduction of supranational currencies are papers by Keynes (ASPW, 1980) and Hayek (Hayek, 1990): however neither of their proposals has been realized. At present there are a number of suggestions for introducing supranational currencies, some of which are based on Keynes' ideas. The author of this paper fully shares the belief that a supranational currency must be used as the international currency. However, before creating such a currency, it is necessary to examine the experience of all international currencies that have actually existed. All past international currencies and their monetary systems had their drawbacks, which is why the international monetary system has been evolving over the whole period of its existence. Therefore the first part of this paper contains a review of the past international currencies and their monetary systems, emphasizing their limitations. Later on the paper proposes an alternative theoretically possible variant of the international currency, with a fixed value relative to a commodity basket. An abstract example is used to demonstrate its composition and circulation mechanism.

2. THE DISADVANTAGES OF USING ONE NATION'S CURRENCY, THE DOLLAR, AS AN INTERNATIONAL CURRENCY

Most economists recognise that the US dollar being used as the international currency is to the advantage of the US. Descriptions of this advantage are given, for example, by Salvatore (Salvatore, 1999), and Frankel (Frankel, 1999). The international usage of a national currency places the nation having its currency used internationally in an asymmetrical position vis-à-vis other nations. The major benefit to the US from the dollar being used as an international currency is seigniorage. In addition, the nation producing the international currency can issue it in accordance with its own interests; for example, it can finance a part of its imports by issuing that international currency. Over the long-term this will

lead to a growth in prices nominated in the international currency. This is due to the domestic economy of the nation issuing the international currency and the world economy being linked by that same money supply. Thus, the nation issuing the international currency is faced with a choice: either to keep up the purchasing power of the international currency (dollar) to the detriment of its own domestic policy, or to pursue its domestic policy in the way that suits it the most, to the detriment of the world economy. As is manifested by the evolution of the international monetary system, the nation issuing the international currency usually pursues its own interests rather than those of the world economy (other nations).

Therefore, a national currency should not be used as the international currency. This is the conclusion that the well-known economist Triffin insisted on back in the Bretton-Woods era (Triffin, 1960).

3. DRAWBACKS OF USING SILVER AND GOLD AS THE INTERNATIONAL CURRENCY

Historically, gold and silver have been the most widespread commodities used as international currencies. The international monetary system has had experience of using both metals (bimetallism) and solely gold (monometallism). We will now describe the advantages and disadvantages of these international currencies.

By the end of the 19th century some nations used gold coins, others silver coins, while still others gold and silver coins together (depending on there being silver and/or gold production in the nation). So it was natural that two international currencies appeared: silver and gold.

Due to significant fluctuations of gold and silver prices at the end of the 19th century (Cooper and Dornbusch and Hall, 1982), trade between nations belonging to different metallic blocs was hampered. In view of this problem, nations adopted the classic Gold Standard.

However, this monometallic system was less fair, as it gave an advantage to those nations and bodies that had accumulated large gold reserves. So, the first drawback of gold as the single international currency is its unequal distribution among nations.

There is another disadvantage to monometallism, which demonstrated itself during the World Wars when a large amount of gold was ‘pumped’ into other nations from the US. This was one of the reasons for abolishing the Gold Standard. After WW2, the US had accumulated more than 50% of the world stock of gold.

A further demerit of the monometallic system is the fact that, given that the international money stock depends on the volume of gold, it is potentially limited, as the global gold reserves are limited by its actual availability and mining prospects.

4. DISADVANTAGES OF THE COMMON CURRENCY (THE EURO) AND COMMON UNITS OF ACCOUNT OF REGIONAL CLEARING UNIONS (FOR EXAMPLE, ASIAN MONETARY UNIT)

The Eurozone is the actual practice of a common currency used in several nations. As in all the nations belonging to the Eurozone the euro is both the national and international currency; all the nations belonging to the Eurozone are in a symmetrical position to each other. However, there exists a different kind of asymmetry in this area. Mundell, the founder of Optimal Currency Areas theory (Mundell, 1961) and advocate of the common currency, pointed out that entering the common currency zone can cause significant expenses for countries. The countries of the Eurozone are not free to use their monetary policy tools to adjust to asymmetric shocks. This is the case in a situation when the nations’ macroeconomic shocks, which might have been mitigated by their monetary policy, are asymmetrical. In most cases there is an alternative to using national monetary policy as an instrument, but these alternatives are often more painful (Grauwe, 2005, p. 22). Thus, those nations whose economic needs are not met by the monetary policy of the common Central Bank are at a disadvantage.

In our opinion, the common currency has one more significant drawback: most nations would not be able to join the Eurozone and those nations find themselves predeterminedly in an asymmetrical position. Let me explain the reason for this. The common currency zone requires that its members should follow a certain set of rules. Theoretically, according to Mundell, the founder of the Optimum Currency Area theory, a high degree of mobility of production factors is a prerequisite for a common currency. In practice, the Maastricht Treaty requires that the macroeconomic indices of candidate countries that are willing to join to the Eurozone should converge. This represents a high bar to entry to the Eurozone, which limits the number of countries that can enter it. Therefore,

nations that cannot enter the Eurozone find themselves predeterminedly in an asymmetrical position (which is similar in reference to the dollar).

Let us examine common units of account of regional clearing unions. As a rule the value of such common units of account is equivalent to some units of other international currencies (for example, the unit of the Asian Clearing Union is equivalent to one USD). Therefore, similar common units of account of regional clearing unions have no potential for becoming the single international currency, as international trade will not be at its most effective unless there is a single international currency (as the usage of a number of currencies heightens the currency risks on both the macro and micro level). This is the major disadvantage of common units of account of regional clearing union in this context.

5. SUGGESTION OF AN ALTERNATIVE INTERNATIONAL CURRENCY

Taking into account the analysis set out above, it becomes clear that all the past international currency units have features that hamper the normal functioning of an international monetary system.

In our opinion, for the normal operation of the international monetary system, the international currency should meet the following essential requirements.

Firstly, the international currency reserves should keep their purchasing power.

Secondly, the operation of the international currency should not offer some countries an advantage over others. Thirdly, being inherently a regional international currency, it should have the potential for becoming a single international currency. Fourthly, the money supply of the international currency should easily expand or shrink if needed.

Not one of the examined international currencies and systems meets one or more of the above requirements.

Set forth below is the suggestion of an alternative international currency, which meets all the above requirements. It is reasonable to use money with a fixed value relative to a commodity basket (several commodities). Before explaining the composition of the proposed alternative currency, let us turn to history. By the end of the 19th century countries had used two international currencies: gold and silver (bimetallism). Then it became clear that the functioning of two

global currencies was inefficient. Therefore countries decided to use gold as a single international currency. As a result some nations found themselves at a disadvantage: the nations that had large silver reserves had to create gold reserves. After a while, the Gold Standard-based system became outdated.

The alternative international currency proposed in this paper would have been and would be the optimal means of resolving both the currency system problems which arose in the late 19th century and those being experienced at present.

Let us explain briefly the composition and circulation mechanism of this proposed alternative currency through the example of an economy that uses two commodities, gold and silver (end of the 19th century). In the author's opinion, an international currency would be the optimal solution to introduce into a system using a currency with a fixed value relative to two commodities - gold and silver - in proportion to their share in the international turnover.

Let us examine an abstract example. Let one unit of the proposed currency consist of one gram of gold and two grams of silver. Therefore one gram of gold corresponds to 60% of the value of one unit of the proposed currency, two grams of silver corresponds to 40% of the value of one unit of the proposed currency. Then all nations would have to adapt their international currency reserve structure to correspond to the structure of the international currency: 60% gold and 40% silver. This would reduce the currency risks of the nations using the proposed currency. This means that nations would have to purchase the necessary metal or metals (gold and silver) at current prices. As opposed to monometallism, the operation of the proposed currency would not give the advantage to those countries whose metal is used as the single international currency.

The prices of all commodities in the global market, including gold and silver, are set and defined in the proposed currency. Therefore the following question could arise. On the one hand, one unit of the proposed international currency is equal to the given composition of metals (in this example it is one gram of gold and two grams of silver). On the other hand, the market prices of silver and gold are also defined in the proposed currency. What effect will this possible discrepancy have on the economy?

The answer is there will be no such discrepancy. The prices of gold and silver will be changing daily: however, one gram of gold and two grams of silver will tend towards one unit of the proposed currency unit. Let me clarify this. If gold and silver prices were to settle down so that one gram of gold and two grams of silver

would cost one and a half units of the proposed currency, this would mean that when purchasing one gram of gold and two grams of silver the buyer would pay one and a half units of gold and three units of silver. This discrepancy (arbitrage) will be offset in the market by a decline in demand and, subsequently, in prices of gold and silver. Hence, one gram of gold and two grams of silver taken together would cost one unit of the proposed currency.

At the same time the prices of the metals will be changing, which will affect the share of silver and gold in the one unit of the proposed currency: it will be subject to daily change.

The proposed currency allows for a change of its structure in the future and change to the composition of commodities in the commodity basket: more commodities can be included or excluded depending on the development of international relations. This makes this currency very flexible, and therefore stable.

In the present-day world, nations may suggest using a currency that has a fixed value relative to different commodities circulating on the world's stock exchanges, e.g., oil, platinum, or other commodities. Nowadays derivatives mean that if a nation has no production or no conditions for the storage of some commodities (sureties), the nation can buy derivatives of these commodities (sureties).

The proposed currency could change its structure and composition periodically, say, once a year. According to such changes, nations would alter their international reserves.

The alteration of the structure and composition of the one unit of the proposed currency will be done in such a way that its value does not change, i.e., the new composition (e.g., three-quarters gram of gold, one gram of silver, and one litre of oil) will be equal in current prices to its previous composition (one gram of gold and two grams of silver), i.e., one unit of the proposed currency.

The proposed currency that is briefly described here through the example of a commodity basket containing gold and silver can be used in the modern international economy with a certain specification. Taking into account that modern international relations feature a vast number of international transactions, it is reasonable to assume the functioning of the proposed currency in a multi-sided currency clearing (ASPW, 1980).

The commodity basket could contain various commodities circulating on world commodity exchanges and the composition of the basket may vary. Depending on each particular composition, the characteristics of the currency and the system it is based on will vary.

6. CONCLUSION

The current international money system, which is based predominantly on the dollar and euro as the leading international currencies in international transactions, entails an increasing number of different costs of various kinds. As a result nations feel the need to introduce alternative currency systems and are considering different variants of alternative international accounting units. Many scholars tend towards favouring the idea of supranational currencies. The author of this paper fully shares the belief that a supranational currency must be used as the international currency and gives proposals for an alternative currency.

This paper analysed the past and present international currencies and the result of this research is the singling out of four main requirements for an international currency.

Firstly, the international currency reserves should maintain a constant purchasing power: having sold a certain amount of a commodity today and received payment in the international currency, which is then added to its reserves, a country should be able to buy an equal amount of the commodity for the saved currency reserves.

Secondly, the composition and the mechanism of the international currency should not create advantages for some nations over others.

Thirdly, being inherently a regional international currency, it should have the potential for becoming the single international currency, as international trade with several international currencies is less efficient than with a single currency.

Fourthly, the money supply of the international currency should easily expand and shrink in accordance with international turnover of goods.

Not one of the examined international currencies and systems meets one or more of the above requirements.

The last section of this paper has proposed a theoretical variant of an international currency (with a fixed value relative to a commodity basket) that meets all these requirements.

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