Richard Kaufman opened the session by reviewing the relationship of security and economics. He spoke of the Cold War period, when all policy was viewed through a war prism. After the respite of the peace dividend of the late 90s, today’s war issues once again infuse economic policy analysis, directly or indirectly, even in discussing the dollar. According to one school of thought, the dollar’s decline is symptomatic of the US decline as a world economic and military power. There are of course other views of the causes and consequences of the decline of the value of the dollar and thoughts on what, if anything, should be done.

Pierre Calame examined the issue of the dollar from the European perspective. Because of the interdependence of China and the US, China has had no choice but to keep buying US Treasury bonds even at a zero interest rate or very close to it. Meanwhile, the G20 has been concentrating mainly on bank regulations and very little attention has been given to the issue of a future international currency. Because the Chinese are obsessed with the risk of a decline in growth, they have kept the yuan anchored to the dollar. This means that the Euro cannot be an alternative international currency. There is also growing suspicion outside the US that the current US government pays too much attention to Wall Street interests and arguments, as if the future of the US economy, society and power is bound solely to its role of financial superpower. None of the structural problems has been fixed; we need a new, enlarged Bretton Woods. This will require careful preparation and a number of deep conceptual and institutional innovations.

Mr. Calame’s agenda proposed five main items for a new Bretton Woods discussion. They are: 1) The stability of the exchange rates between four major regional currencies: the Americas (North and South), Europe (including Russia and Africa), East Asia, South Asia; 2) A regional monetary system in each of these four regions; 3) A new approach for energy and commodity management. Here, two issues must be addressed: the short term stability of energy prices through the creation of global regulating stocks, and a new regime of governance for energy in order to move towards sustainable societies and inter-regional justice; 4) Periodic adjustment of imbalances with institutional coordination under the guidance of the IMF; 5) New regulations for pension funds, orienting them in the direction of long term investment.

Next, Jane D’Arista noted that there is already a problem with the dollar – in the monetary system itself. One of the key roles of an international monetary system is to recycle payment imbalances. The current inability of the US to serve as a consumer of last resort means that the system is already in jeopardy. Dr. D’Arista noted that there is an aspect of the international monetary system that is seldom written about or taken into account: it generates credit, since it is based on foreign exchange reserves, rather than on a gold-based system. She discussed how the contraction of credit was a major factor in the Depression, and how it is important also
to look at both stocks and flows in the foreign exchange reserve system. The tendency has
been to focus on flows, knowing that there are deficits to finance in the US. However, many of
the problems with the system are on the stock side. For instance, in 2005 when Japanese
banks were allowed to lend yen, in order to reduce the Japanese reserve stock, there was an
incredible build up of financial sectors around the global economy. Foreign exchange reserves
have the virtue of being transactional reserve regimes, thus involving the private sector.
Therefore, a crisis in the international system, or with the dollar, is most often triggered by an
event in the private financial sector.

Where can the system go, moving forward? One often hears that other currencies will pick up
the slack, but Mr. Calame made the point that that will not happen. So the discussion turns to
SDR (Special Drawing Rights) as the potential international currency. The problem with SDRs
is that they are only capable of transactions between central banks. None of the current
proposals overcome this shortcoming. Dr. D’Arista proposed an alternative: an international
authority that will sell bonds and require member countries to buy those bonds and use them
as reserves. The income from the bonds would be used for public purposes, such as
development, infrastructure, climate change, etc. The member countries would guarantee the
value of the bonds. A new Bretton Woods, as Mr. Calame said, is absolutely essential. We
should think not just in financial terms, but also fiscal terms of the global economy and how the
new system would balance payment imbalances.

Jan Kregel began with the question, “If you are going to replace the dollar [as global reserve
currency], what problem do you think this is going to solve?” If the problem can be identified,
one can then identify alternative solutions. One of the complaints is that the large holders of
dollar reserves are worried about the value of their holdings. One very large holder of US dollar
reserves held agency securities and, when Fannie and Freddie Mac were about to be allowed
to collapse, this holder intervened to engineer a US government bailout. Is the US really going
to bail out all of the foreign holders of its government securities? Obviously that will not
happen, because all that will provide are more dollar balances. The idea that the international
value of dollar holdings is guaranteed, or must be guaranteed by the government, is economic
nonsense. It cannot be done.

Perhaps the problem is the volatility of the dollar exchange rate. This volatility is because
foreign exchange is an asset class and investors invest in foreign exchange. Secondly,
because countries have independent national monetary policies interest rates tend to differ,
which also produces instability. A simple solution to this sort of flexibility would be to go back to
fixed exchange rates – which nobody seems very interested in doing. Another simple solution
to dollar volatility is to remove foreign exchange as an asset class; that is, introduce some sort
of international capital controls. The original Bretton Woods system was based on the
assumption that most international flows would take place through international institutions like
the World Bank. So, this is another alternative that does not require replacing the dollar with
something else.
The Triffin Paradox says that any system based on a national currency will conflict with other nations’ policies, and create the necessity for international policy coordination which, by definition, must fail. So, we cannot replace the dollar with any other national currency.

If we remove the dollar as international reserve currency, some other asset must then be created. The dollar is a liability on the US Fed balance sheet, offset by US government debt on the asset side. If everyone moved to an international currency, who would provide the debt? The international government, obviously, which would engage in international expenditure and fiscal policy. There would be unimaginable difficulties in deciding what the international deficit would have to be in order to secure global full employment.

There is a conflict, a trade-off, between currency value and labor value. The problem is to design an international financial system that stabilizes both the value of currency and the level of employment. It’s not just about the dollar, or its value, or the value of international dollar holdings. It’s a question of the value of the major asset that every country possesses: its labor force and its ability to use the labor force to generate national wealth.