International Financial Reform and the Strategy of Korea

Robert Mundell
Columbia University
June 24, 2011
Youido Institute
Seoul, Korea

Phases of the International Monetary Systems over Two Centuries

Bimetallism	1815--1873
Int'l Gold Standard	1873 -- 1914
Dollar-Gold Standard	1915 -- 1924
Gold Exchange Standard	1925 -- 1933
Dollar-Gold Standard	1934 -- 1971
Dollar Standard	1971 -- 1973
Flexible Exchange Rates	1973 -- 1999
Fluctuating Currency Areas	1999 --

Another Look

Date	System	Reserve Asset	Leaders
1803-1873	Bimetallism	Gold & Silver	France, Britain.
1873-1914	Gold Standard	Gold and £	Britain,
1915-1924	Anchored $ St.	Gold and $	U.S., Britain, France
1924-1933	Gold Standard	Gold,$ and £	US, UK, France
1934-1971	Anchored $ St.	Gold and $	U.S., G-10, Britain
1971-1973	Dollar Standard	$	U.S.
1973-1985	Flex. Ex. Rates	$, DM, £	U.S., Germany, Japan
1985-1999	Man. Ex. Rates	$, DM,	U.S., G-5, IMF
1999-2011	Dollar and Euro	$, €, ¥,	U.S. EMU, IMF
2011-?	Currency Areas	$. €, ¥, £, C¥,	US,, EMU, China

The Context: Three Great Booms

- The first was 1982-90, the “Seven Fat Years” of the Reagan administration.
- The second, in 1991-2001, was the longest expansion in American History.
- The third great boom was the Bush expansion of 2002-08.

Four Acts of the Great Crisis

- 1. The *sub-prime mortgage* crisis crystallized on Aug 9-10, 2007.
- 2. The Sept 15, 2008 bankruptcy of Lehman Bros, AIG and its aftermath.
- 3.The economic contraction that occurred from 2008(3) to 2009(1).
- 4. The Euro deficit-debt fallout of 2010

Why the Lehman Crisis of 2008?

- The sub-prime mortgage crisis had been managed with the unprecedented $300 billion central bank bailouts of August 9-10, 2007.
- Question: What detonated the Lehman crash more than a year later?
- The answer: the Federal Reserve Board let the dollar soar by 30% after June 2008.

Symptoms of Monetary Tightness in 2008(3)

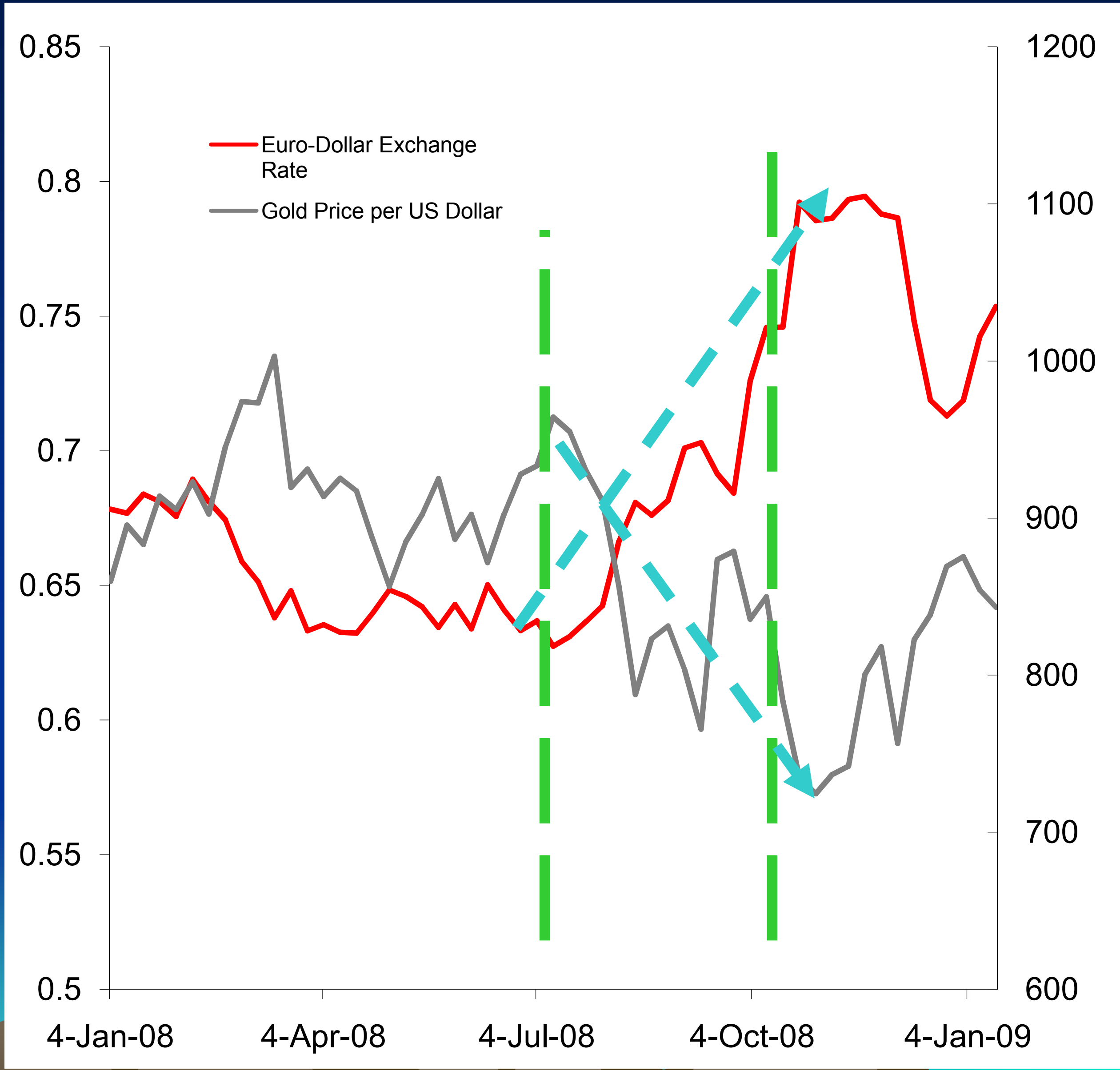
- Soaring Dollar
- Plummeting Gold
- Plummeting commodity prices
- Plummeting inflation rate to DEFLATION!

Record of Tight Money in last half of 2008

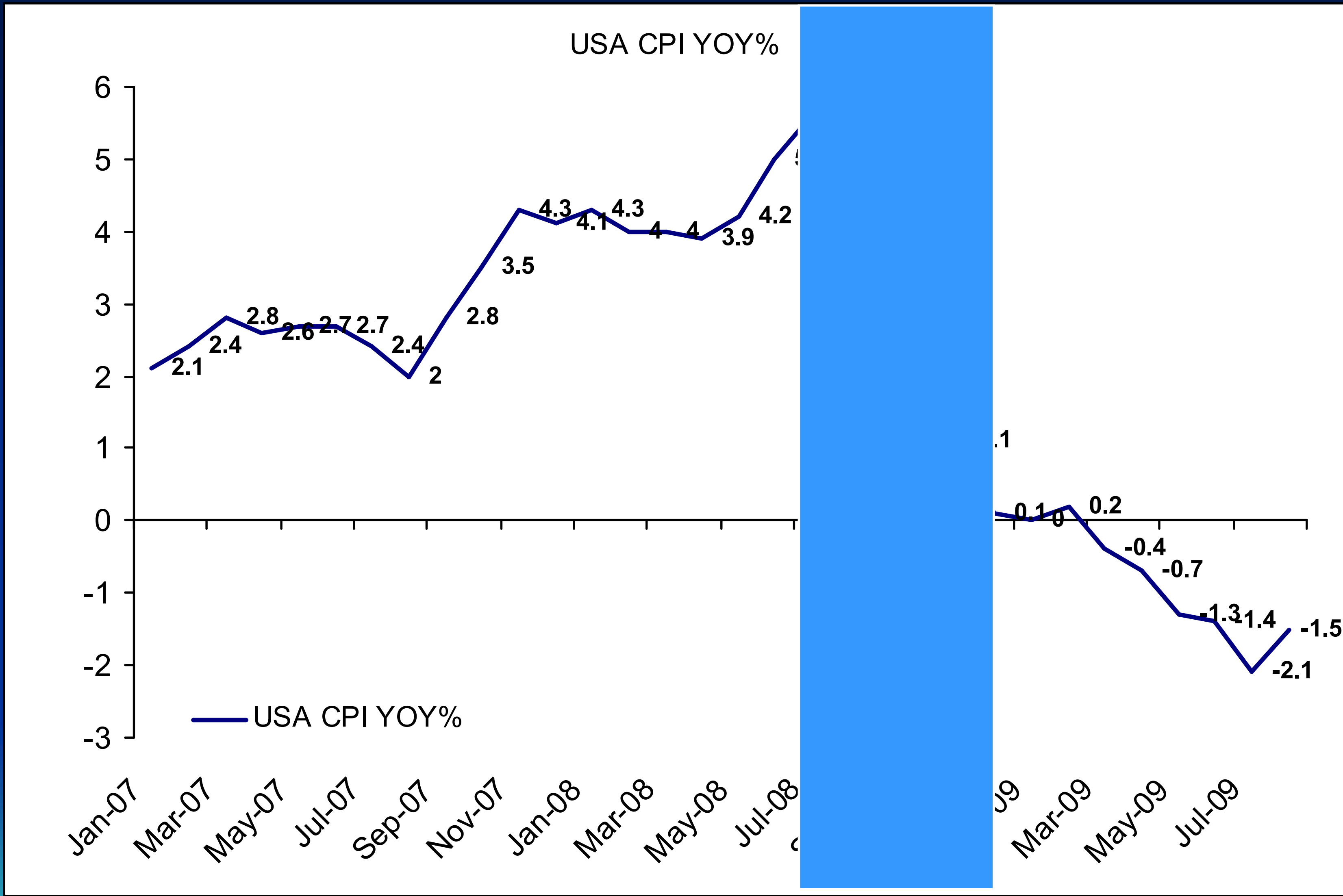
- Soaring Dollar—30% appreciation against euro
- Falling Price of Gold—30% fall
- Collapsing Oil prices—70% fall
- Monthly Inflation Rate (annualized) lowered from 5.5% in June 08 to negative in early 2009.

The Dollar in Euros and the Price of Gold in Dollars in July and November 2008

	Euros per Dollar	Dollars per Euro	Gold ounce per Dollar
July 15, 2008	0.63	1.60	980
Oct 27, 2008	0.80	1.25	720



0.85
0.8
0.75
0.7
0.65
0.6
0.55
0.5
1200
1100
1000
900
800
700
600
Euro-Dollar Exchange Rate
Gold Price per US Dollar
4-Jan-08
4-Apr-08
4-Jul-08
4-Oct-08
4-Jan-09

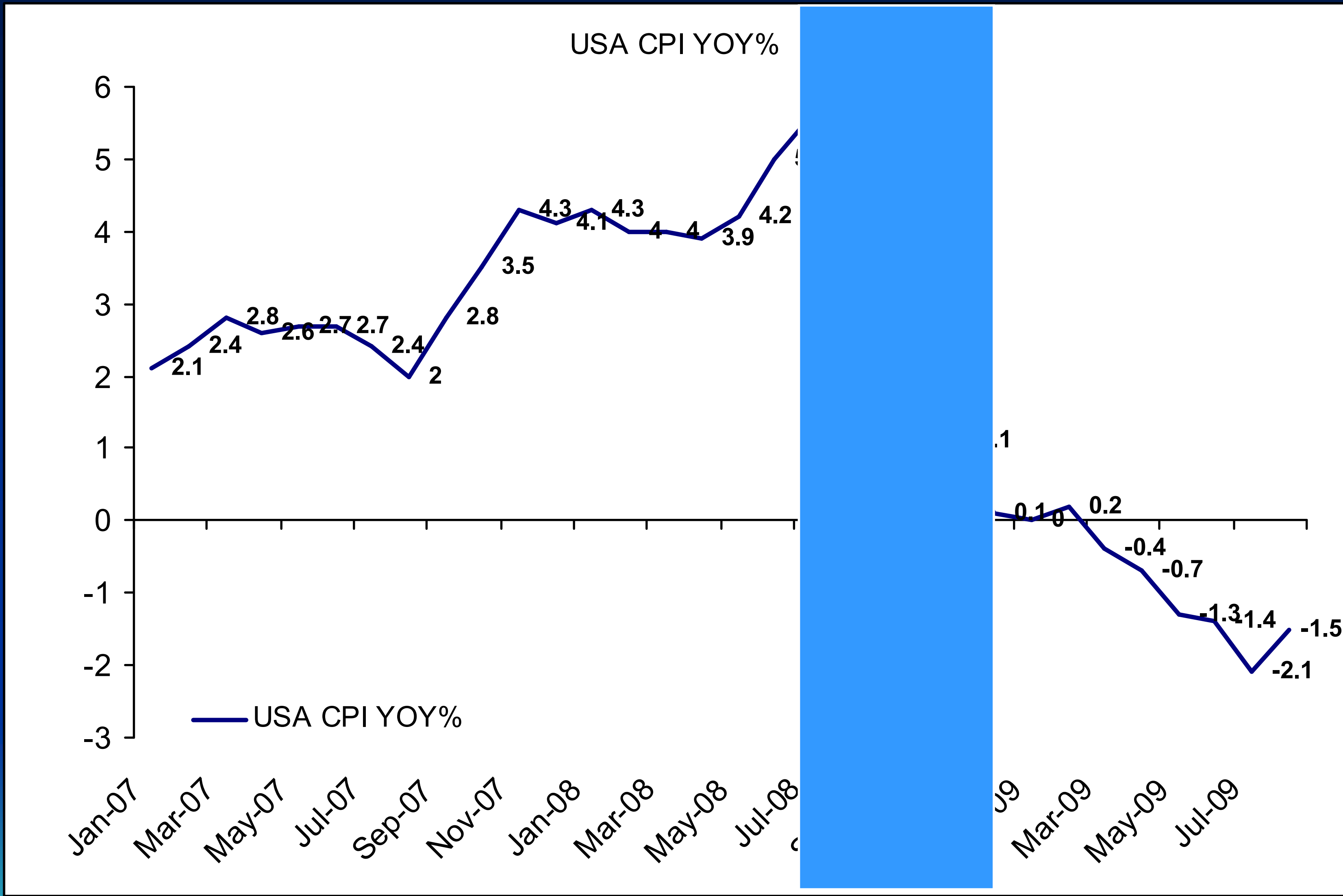

USA CPI YOY%
6
5
4
3
2
1
0
-1
-2
-3
2.1
2.4
2.8
2.6
2.7
2.7
2.4
2
2.8
3.5
4.3
4.1
4.3
4
4
3.9
4.2
0.1
0
0.2
-0.4
-0.7
-1.3
-1.4
-2.1
-1.5
USA CPI YOY%
Jan-07
Mar-07
May-07
Jul-07
Sep-07
Nov-07
Jan-08
Mar-08
May-08
Jul-08
Mar-09
May-09
Jul-09

Failure of Lehman

- A suitor for Lehman, Korean Development Bank backed away.
- Paulsen and Bernanke decided not to save Lehman.
- Dollar appreciation dealt the final blow.

QE1

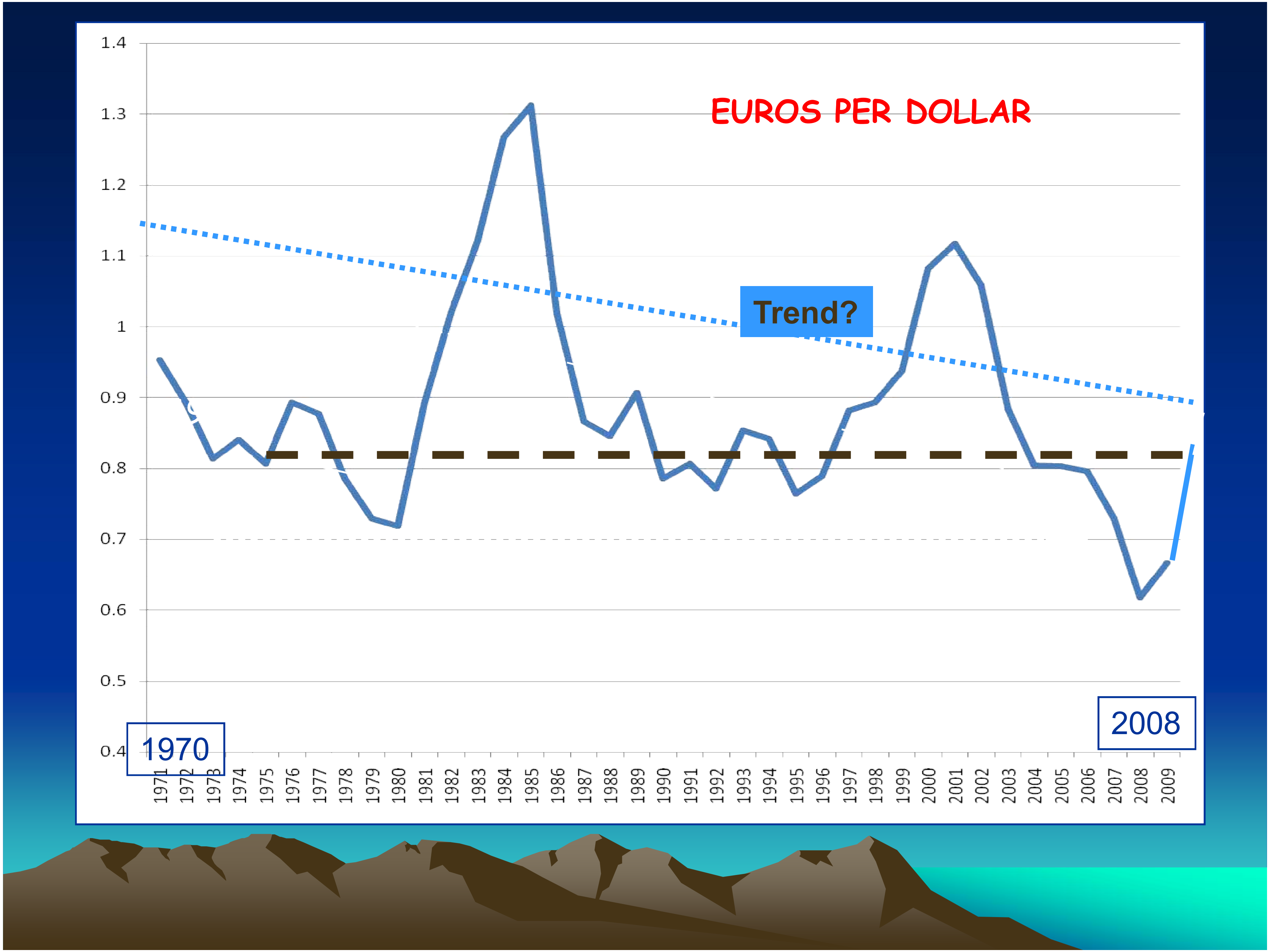
- The recession continued with deflation setting in at the end of 2008 and running through the first half of 2009.
- In March 09 the Fed announced a massive purchase of up to $300 billion of government bonds.
- This was QE1.



USA CPI YOY%
6
5
4
3
2
1
0
-1
-2
-3
2.1
2.4
2.8
2.6
2.7
2.7
2.4
2
2.8
3.5
4.3
4.1
4.3
4
4
3.9
4.2
0.1
0
0.2
-0.4
-0.7
-1.3
-1.4
-2.1
-1.5
USA CPI YOY%
Jan-07
Mar-07
May-07
Jul-07
Sep-07
Nov-07
Jan-08
Mar-08
May-08
Jul-08
Mar-09
May-09
Jul-09

Aborted Recovery

- With Quantitative easing and a shift to a low dollar, the recovery began around June 2009.
- But in the fall of 09 and the spring of 2010, the dollar began to soar against the euro.
- The euro fell even further than it had in October 2008, falling to $1.18.
- This policy choked off the recovery.


EUROS PER DOLLAR
Trend?
1970
2008
1.4
1.3
1.2
1.1
1
0.9
0.8
0.7
0.6
0.5
0.4
1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009

Dollar-Euro Cycle

- From the chart you can see two huge upward spikes in the dollar, that occurred during the early 1980s, and in the late 1990s.
- The first occurred because of the supply-side policy mix under Reaganomics: tax cuts and tight money.
- The second occurred because of the Silicon Valley IT Revolution and exploding US growth in the late 1990s.

G-20 Meetings

- G-20 meetings in Korea on Nov 11-12, 2010 considered quantitative limits on imbalances.
- France assumed the chairmanship of G-20 after the Korea meeting.
- Pres. Sarkozy raised the question of international monetary reform.

The Sarkozy Critique

- Sarkozy argued that reform of the international monetary system is needed to address/correct three issues:
- Instability of exchange rates
- Instability of raw material prices
- Need for improved governance of the system.

International Monetary Reform

- Metal-Anchored Systems until 1971
- Dollar Dominant currency since 1915
- Bretton Woods Revised Gold Standard to allow for Dollar Hegemony
- Could Bretton Woods Be Reestablished with new Gold Price?
- US and Europe's Gold Reserves
- The Price of Gold

Outline of the Future of the System

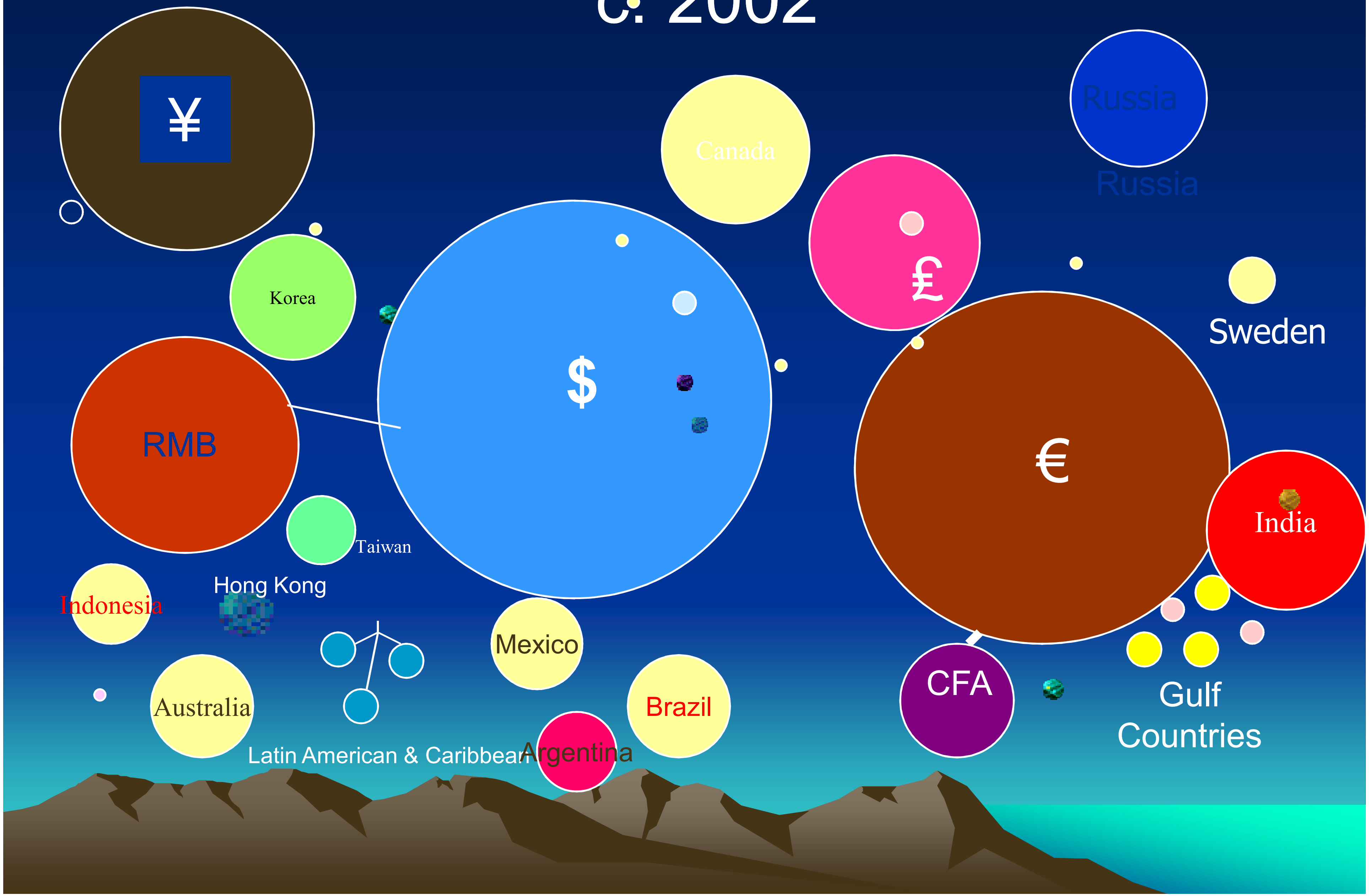
- Dollar Euro Exchange Rate
- Dollar-Euro Gold Fix to sell, not buy
- Creation of DEY
- Agent of Fund for Anchor.
- Creation of INTOR
- Gold's Place in 21st Century

Currency Areas Before the Euro: 1990

Creation of the Euro

- 11 countries entered the euro zone in 1999, soon followed by Greece.
- It made the EMU area a currency area comparable in size to the Dollar area.
- Had Britain joined, the GDP of the euro area would exceed the inner dollar area.

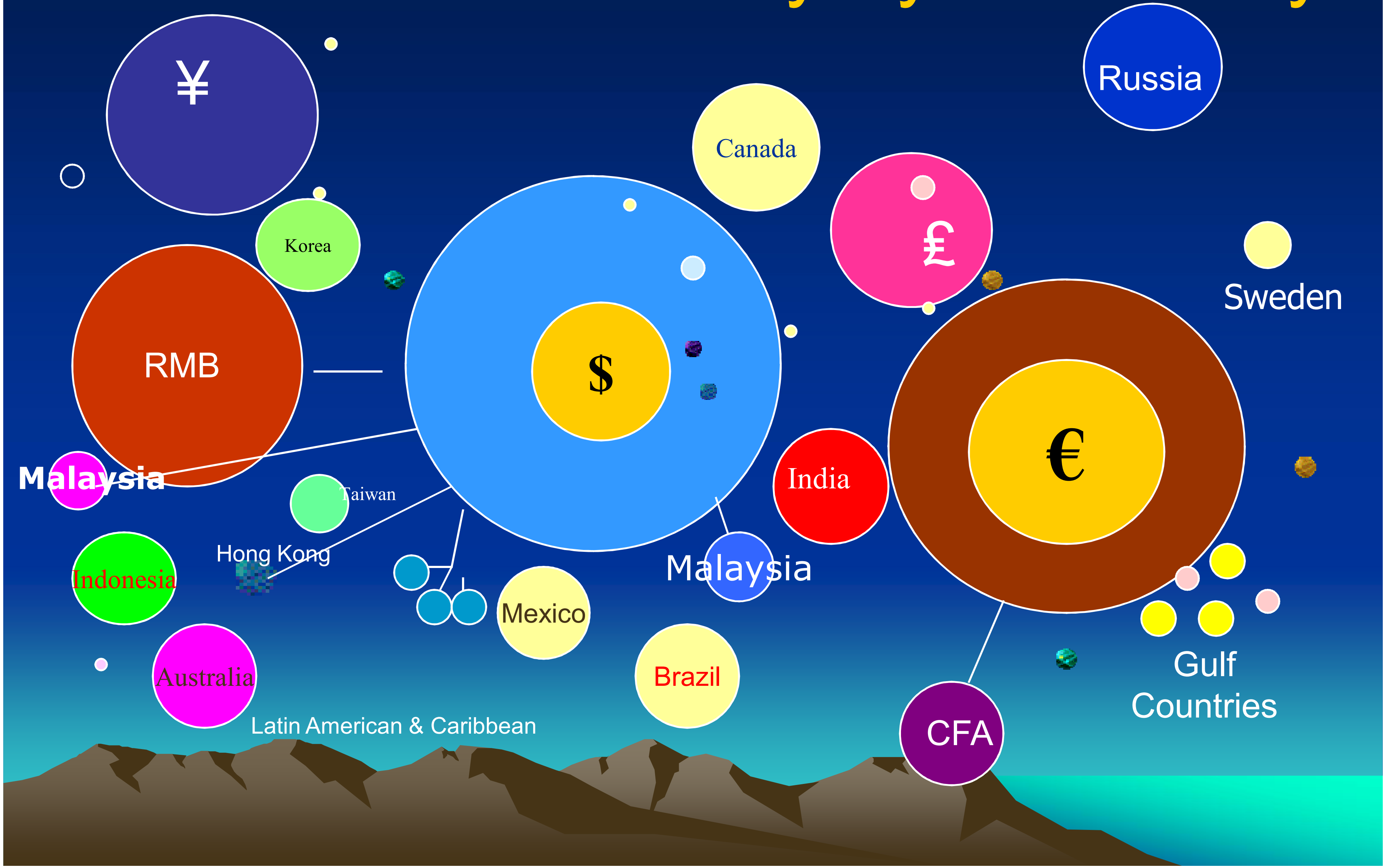
Currency Areas after the Euro, c. 2002



Severing the Mainstream

- The creation of the euro in two steps in 1999 and 2002 completed the task begun by the EMS in 1978 of severing into two parts the mainstream of the world economy.
- Besides its great benefit to the power and cohesion of Europe, the euro has altered the power configuration of the international monetary system

Power Configuration of the International Monetary System Today



Consequences of the Split

- The dollar is less universal as a unit of account.
- The continued role of the dollar for oil prices is not assured.
- The dollar is less useful as an anchor because of third country effects.

World Currency in IMF Proposals in 1944

- The original Bretton Woods plans called for a world currency.
- The British plan identified with Keynes called for an "International Clearing Union with bancor,
- The American plan identified with Harry Dexter White proposed a world currency called unitas,

The SDR

- The world currency idea was rejected by the U.S. at Bretton Woods,
- But the U.S. agreed to the SDR (Special Drawing Rights) in 1967, which could have formed the basis for a world currency.
- That recognized the need for a world currency, although the SDR was never allowed to take off.
- The dollar still represented the mainstream.

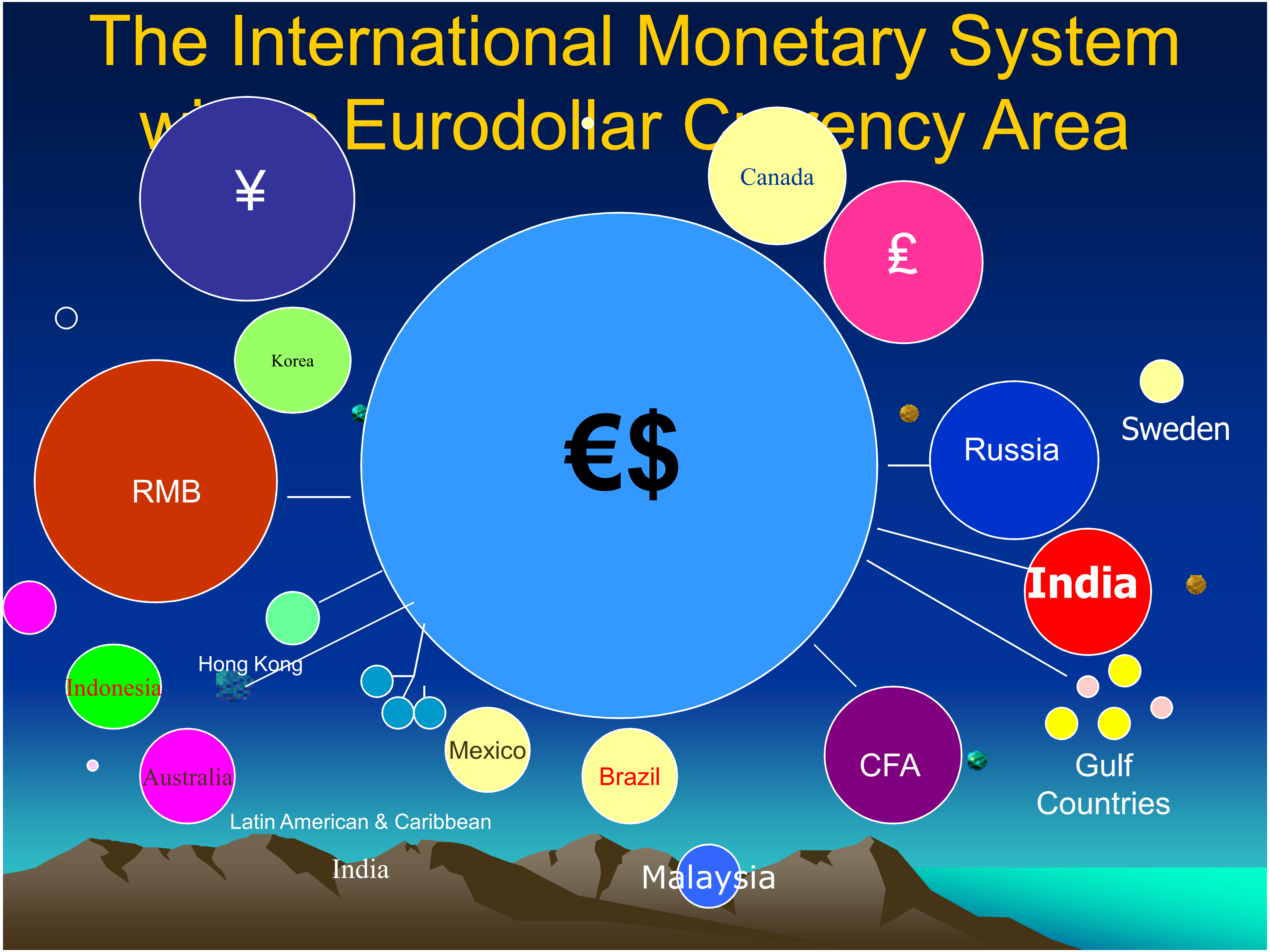
No International Monetary System Possible with Huge Swings

- Today there is no possibility of the SDR or any variant of it becoming a world currency in the sense of a substitute for the role of the dollar in its heyday.
- Given the importance of the dollar and the euro, there is no possibility of forming an international monetary system while the dollar and euro rates are subject to huge swings like that of the years 1999-2011.

The Case for Stabilizing the Euro-Dollar Rate

Advantages of a Eurodollar Fix

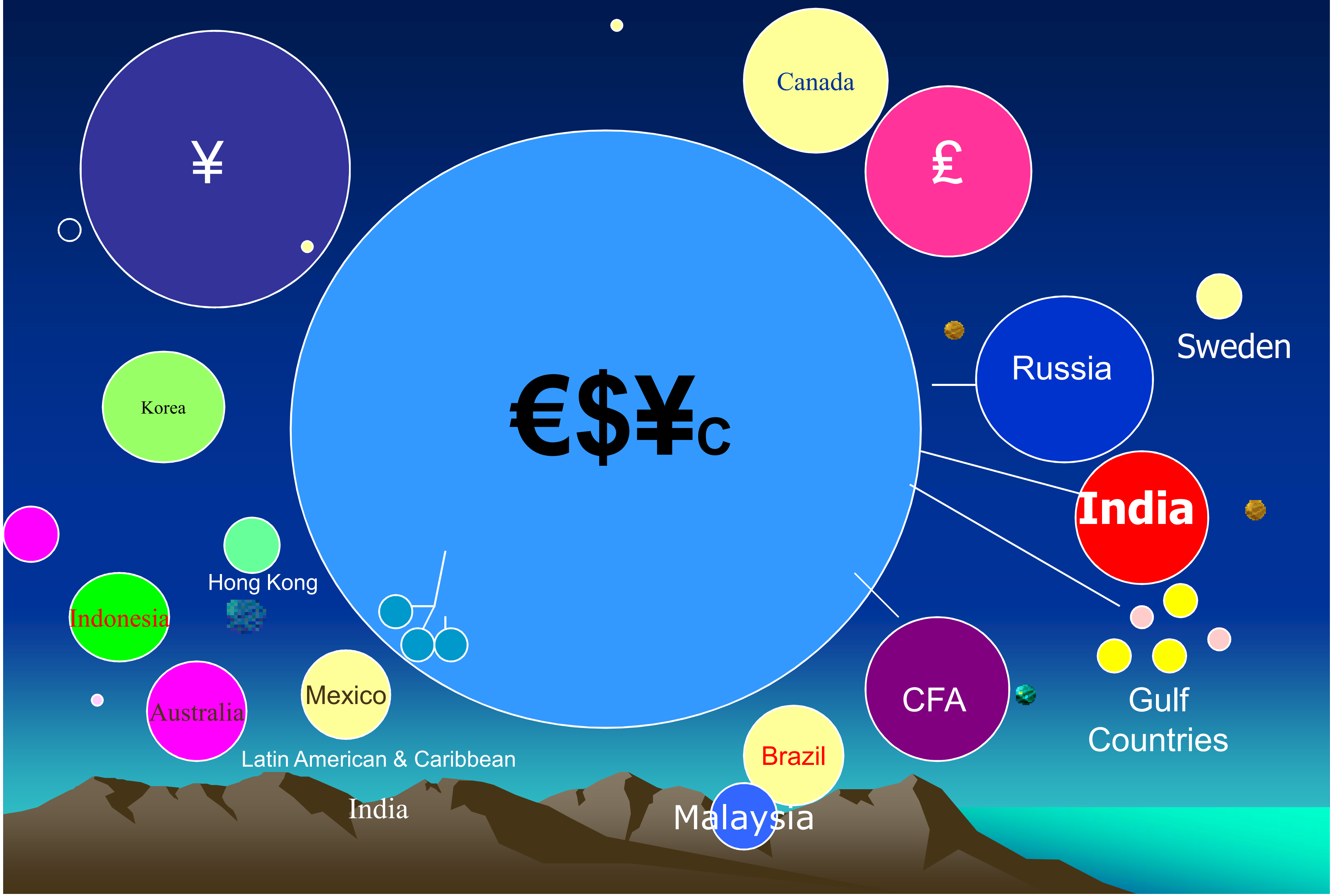
- The European and American currency areas together constitute at least 40% of the world economy.
- If a joint Eurodollar could be created, it could become the anchor for a new world monetary system and a global currency.
- As Paul Volcker says, “the global economy needs a global currency.”


The International Monetary System
w Eurodollar C ency Area
¥
Canada
£
Korea
€$
RMB
Russia
Sweden
India
Hong Kong
Indonesia
Mexico
Brazil
CFA
Gulf Countries
Australia
Latin American & Caribbean
India
Malaysia

Details

- Fix the euro-dollar exchange rate at first within wide limits, e.g., €1 = $1.20 and €1 = $1.40.
- The central point could be made a weighted average of market exchange rates over a past period to be defined.
- The ECB defends the dollar at $1.40; the Fed defends the euro at $1.20.
- Intervention agreed between the ECB and FED can also take place within the limits to prevent sudden and unwanted swings, like that which occurred in 2008(3).

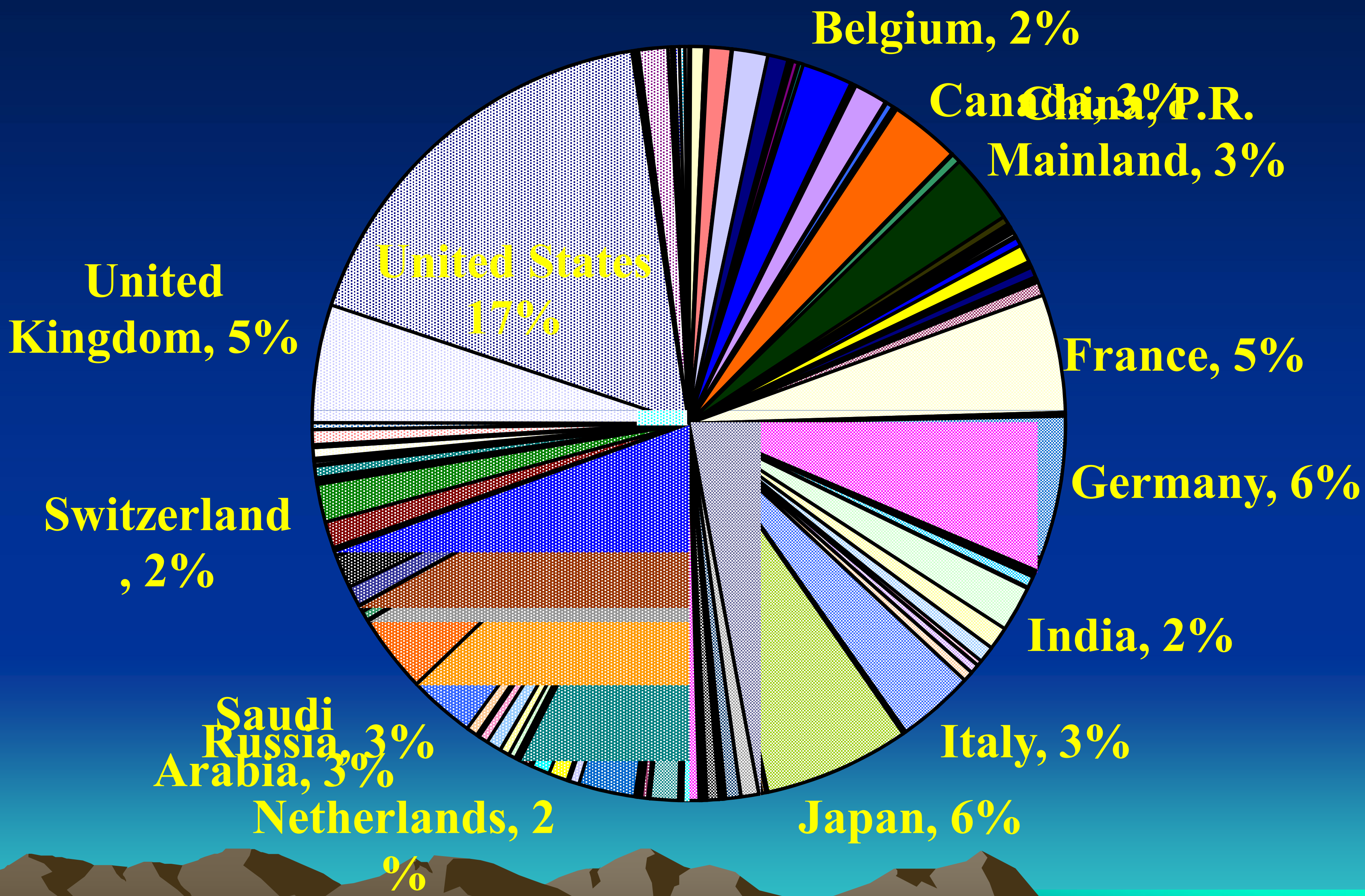
China and the Eurodollar?



The INTOR World Money

- The euro-dollar could then become the central pivot for a restored international monetary system.
- A world currency, the INTOR, based the Eurodollar as an anchor pivot, could be created for the IMF system as a whole in which every member of the Fund would share.

Quotas in IMF



Thank You!