Handle with care

China suggests an end to the dollar era.

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IN FUTURE, changes to the international financial system are likely to be shaped by Beijing as well as Washington. That is the message of an article by Zhou Xiaochuan, the governor of the People's Bank of China. Mr Zhou calls for a radical reform of the international monetary system in which the dollar would be replaced as the main reserve currency by a global currency. It is a delicate issue, however. When Tim Geithner, America's treasury secretary, discussed the proposal in New York on March 25th, his remarks sent the dollar tumbling before he made clear that, naturally, he thought the greenback should remain the dominant reserve currency.

Mr Zhou's proposal is China's way of making clear that it is worried that the Fed's response to the crisis—printing loads of money—will hurt the dollar and hence the value of China's huge foreign reserves, of which around two-thirds are in dollars.

He suggests that the international financial system, which is based on a single currency (he does not actually cite the dollar), has two main flaws. First, the reserve-currency status of the dollar helped to create global imbalances. Surplus countries have little choice but to place most of their spare funds in the reserve currency since it is used to settle trade and has the most liquid bond market. But this allowed America's borrowing binge and housing bubble to persist for longer than it otherwise would have. Second, the country that issues the reserve currency faces a trade-off between domestic and international stability. Massive money-printing by the Fed to support the economy makes sense from a national perspective, but it may harm the dollar's value.

Mr Zhou suggests that the dollar's reserve status should be transferred to the SDR (Special Drawing Rights), a synthetic currency created by the IMF, whose value is determined as a weighted average of the dollar, euro, yen and pound. The SDR was created in 1969, during the Bretton Woods fixed exchange-rate system, because of concerns that there was insufficient liquidity to support global economic activity. It was originally intended as a reserve currency, but is now mainly used in the accounts for the IMF's transactions with member countries. SDRs are allocated to IMF members on the basis of their contribution to the fund.

Mr Zhou's plan could win support from other emerging economies with large reserves. However, it is unlikely to get off the ground in the near future. It would take years for the SDR to be widely accepted as a means of exchange and a store of value. The total amount of SDRs outstanding is equivalent to only $32 billion, or less than 2% of China's foreign-exchange reserves, compared with $11 trillion of American Treasury bonds.

There are also big political hurdles. America would resist, because losing its reserve-currency status would raise the cost of financing its budget and current-account deficits. Even Beijing might want to rethink the idea. Mr Zhou praised John Maynard Keynes's proposal in the 1940s for an international currency, the "Bancor", based on commodities. But as Mark Williams of Capital Economics says, central to Keynes's idea was that a tax be imposed on countries running large current-account surpluses, to encourage them to boost domestic demand.

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