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Future of Currency

The Global Challenge

I see that greatest challenge for the next decade to be a fundamental one - what should the world's currencies be? Over the last century we have seen the rise of the US dollar as the primary unit of global currency which we use to measure and value much of our relative individual, organisational and national wealth and investments, and through which we exchange, trade and price commodities, businesses, goods and services. The status of the US dollar as the global reserve currency is however under enormous pressure and, with the rise of new currency blocs in the world, many have been asking whether the Euro will emerge as an alternative reserve currency. The 2008-9 financial crisis put enough pressure on the US currency to such an extent that many now see that we need an alternative, but the question is what? Will the US remain as the pre-eminent financial power or will its influence secularly decline stimulated by the recent crisis and its inability to achieve a major technological breakthrough or exercise the necessary conditions for it to remain a reserve currency? And, if we go for an alternative, why would this be the Euro?

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By 2020, will we, for instance, therefore see the ACU (Asian Currency Unit) develop from an Asian Monetary Union to become the third global currency alongside the Euro and the dollar? While Asia may not be ready for a common currency, the time is right to work towards a parallel currency. Furthermore, within this context, would the ACU be pegged to the Yuan or the Yen? And will the Rupee be part of the basket that determines the value of the ACU? These global currency reserve questions are a primary challenge for the world's economies for the next ten years.

While I see that this is the main issue, I believe that during the next decade we will also have to address two other significant issues along the way:

One of the most important of these is the continuation of money laundering that will increasingly impact the smaller economies as the larger ones take steps to minimize the impact on their own systems. Will such countries as Switzerland and The Bahamas, as well as other financial havens, finally be brought into the financial mainstream and stop affording haven status to residents of other countries? Will the advanced economies come together and force the emerging economies to join in the move against laundered and ill gotten wealth?

We also have the impact of replacing printed and minted money with electronic equivalents: The move to digital money will certainly raise a number of major issues. Especially as the banking and mobile telecommunications sectors see their interests converge in developing more widespread electronic transactions which will minimise the use of cash, or even traditional credit as we know it, digital money will have increasing applicability. As banks adopt new software and the Bank for International Settlements develops guidelines for electronic money, its movement across national borders will become practical. However, what is the real pace of the related technologies and who either individually or collectively will emerge as the real driver for this convergence? Given the access gap that still exists for significant proportions of the population in many developing nations, will we need to wait for true, near ubiquitous mobile connectivity and 24/7 energy supply before digital money can really have global impact?

Both of these issues will have impact upon international remittances, inter-bank transfers and the many associated financial vehicles that are presently in place.

Options and Possibilities

De-leveraging is already happening as individuals and governments across Asia decrease their investments in the US dollar.

It is certain that for the next decade the US dollar will remain as one of the reserve currencies. As such it will still be a key currency for foreign exchange and a transaction currency for international trade and investments in 2020. The US dollar will continue to be integrated into, and influential upon, the world economy.

Over the same period, it is possible, but not highly probable, that the Euro will become a major reserve currency. Although the European Monetary Union led to the public introduction of the Euro in 2002, this was twenty years after the first creation of the ECU as an artificial basket currency used by participating countries as their internal accounting unit. It is unlikely that, another two decades later, the Euro will have become quite as significant a currency as the dollar, but it may not be far off. A world where the Euro has equal status to the dollar as a reserve currency is increasingly credible.

However, at the same time, it is certain that the Yuan is emerging as the central focus for economic and financial activity in Asia with increasing number of transactions occurring in that currency, though with limited convertibility. We have seen the rise of China to become the world's primary economic power. This is accompanied by a similar rise of India and the associated rebalancing of wealth between the West and the East. Although the recent economic model has largely been one where Asians produce goods that are bought by Americans using money that is lent back to them by the Asians, this may not last much longer: As a number of commentators, including historian Niall Ferguson, have argued this 'Chimerica' balance is not sustainable in the long term and, as such, a leverage based model cannot continue. The 2008 shock to the global financial system could have significant influence: De-leveraging is already happening as individuals and governments across Asia decrease their investments in the US dollar.

That said, over the next decade, it is unlikely that we will really see the emergence of the ACU as the third currency block. This is because Asians cannot decide on either a viable collation or leadership by one of the countries. As experts, including Jin-Chuan Duan at the National University of Singapore, have highlighted: although much debated, Asian Monetary Union looks unlikely in the short term. Just as with the formation of the ERM and the Euro, the realisation of the ACU as a single regional currency would demand cross subsidy via taxation between countries, the loss of autonomy in the conduct of monetary policy and the partial surrender of some national sovereignty: Right now the Asian version of the Euro is theoretically possible but practically far from certain. However, dual currency systems are common and I believe that, although Asian Monetary Union is improbable by 2020, a parallel currency ACU that allows for exchange rate adjustments is practical. But the ACU must be based on a wider basket than just the ASEAN countries.

Proposed Way Forward

Over the next decade, we will move unmistakably towards a multi-polar world which will be characterized by a much broader consultative process that extends to a larger number of jurisdictions. Greater coordination amongst major economies on financial sector regulation will be needed, and this can be facilitated by the newly enlarged Financial Stability Board based in Basle. At its core, the coordination will have to be aimed at achieving greater trust in the transparent and universally applicable working of the financial system. This will especially need to dispel the fear that the global financial system has a bias in favour of any one country or group of countries or group of dominant institutions. As the G20 has superseded the G7, financial management of the global system must become more equable: Within this it is possible that a more prominent role is given to Special Drawing Rights - the international reserve assets managed by the IMF that currently amount to over $300 billion. It was used to boost global liquidity in 2009, but additional ongoing and arguably more proactive applications should be made more practical.

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In a similar manner to how Shell's current global scenarios outline the future for the energy sector, I see that the challenge in the financial world is to also ensure that we try our best to follow the 'blueprint' and not the 'scramble' approach: I suggest that we need to strengthen the global coordination mechanisms to facilitate the monitoring of global financial flows and enable the emergence of new technologies to help balance the system. The major economies represented in the G20 need to agree to have some arrangement for a universally acceptable reserve currency, starting as a unit of account and then also phasing it in as a currency of exchange. I believe that we should adopt such a universally acceptable currency that does not face the risk of being debased as a result of the fiscal and financial indiscipline on the part of any one country. The ACU has the potential to be that currency. But to function as such it must include the Rupee: India is currently the largest economy of South Asia and plays a far more influential role across Asia as a whole than many of the ASEAN countries. The ACU has been seen as a precursor to a common future currency, just as the ECU was for the Euro. Therefore, it is important to focus on how the world will therefore look when this occurs - India is currently poised to be the third largest economy in the world over the next 30 years. Hence the inclusion of India in Asian economic monetary integration is prudent.

Many would correctly suggest that a true single world currency is not practical: Differential interest rates and selective monetary policies make it impossible and currency harmonization cannot readily be implemented while different countries are in different stages of economic development. The IMF is not a super central bank and turning Special Drawing Rights into a world currency is neither possible nor practical. However, the introduction of a broad basket ACU as the third global reserve currency will provide the world with the opportunity to more appropriately balance economic influence and trade.

Impacts and Implications

If the ACU is positioned alongside the US dollar and the Euro as a third global reserve currency the broader implications will be far-reaching.

The successful acceptance of an ACU driven by a wide basket of national currencies will, in itself, have several significant impacts within Asia: If the ACU is positioned alongside the US dollar and the Euro as a third global reserve currency the broader implications will be far-reaching.

When the European Monetary System first came into effect in March 1979, few people believed that within two decades a single European currency would be a reality. At the time of inception the European Currency Unit (ECU) had as little chance of becoming Europe's currency as Special Drawing Rights (SDR) had of becoming the world's currency.

If the Asian Development Bank takes the European model forward and creates a parallel currency that is a plural basket of national currencies, the Asian region as a whole will gain some decoupling from the US dollar. This will allow economic agents in the region to invoice financial and trade transactions in a common currency and reduce exchange rate risks as well as channel Asia's savings more efficiently within the region. As a regional benchmark, the ACU will help share the degree of divergence of each participating countries' currencies, which will improve the understanding of generic problems in a particular currency's market and in pursuing macroeconomic policies. The ACU can be used to devise new instruments that can be easily traded across borders; importers and exporters can denominate intra-Asian trade in ACU; and governments and corporate bodies may wish to issue bonds in ACU and banks can take deposits and provide loans denominated in ACU. The widespread use of ACU will definitely increase the extent of financial and trade integration in this part of the world. As such Asia as a whole, rather than as individual countries, will achieve more balanced influence in the global economy.

To overcome the obstacles that currently exist, such as strengthening the Chaing Mai Initiative and the Asian Bond Fund and managing diverse exchange rates, we clearly need to create and strengthen international safeguards and promote the use and acceptance of a parallel currency. The move towards an ACU as a legal tender alongside domestic currencies will necessitate significant monetary and exchange rate cooperation among participating countries and, as with Germany in Europe, the role of a centre country or centre countries also needs to be clear.

The US dollar currently acts as the de facto parallel currency in Asia, just as it did in Europe in the early 1970s. However the fast emerging global rebalance is very different to the world of the 1970s and necessitates a move away from the dollar. It is in the interest of the Asian central banks to move away from the dollar to assets denominated in an alternative currency, and the ACU can be that alternative. If the ACU becomes a global reserve currency then a much-needed, major world shift can occur: Central banks can diversify their foreign currency reserves and hold part of their reserves in ACU; investors can invest in ACU denominated instruments; and both corporations and national governments can finance their operations by issuing ACU denominated debt. Such a move will have a positive impact on reduction of global imbalance as it will hasten the depreciation of the US dollar vis-à-vis other countries.

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