3. Unfinished business

Ken Coates

As if to offset the dismal reports from various battlefronts, the summit of the G20 has been welcomed as a breakthrough in international co-operation. But thoughtful commentators are now telling us to focus not on the G20 nations, but the G2. The G2 are the United States and China, and their accord is required if the agreement of the G20 to treble the funds available to the International Monetary Fund is to become a reality. The G20 thought it was necessary to multiply IMF resources to $750 billion, and also to sustain a $250 billion allocation of Special Drawing Rights (SDRs), which would enable the IMF to go some way towards meeting the innumerable demands which are about to be made on it. But all this extra money has to be gathered in, and if it is to be made available, then the rules of the IMF will require serious attention. This takes us back to the origins of the organisation.

Lord Keynes had proposed that the IMF should float a new currency unit of account, the Bancor. Fierce and sustained opposition from the Americans put a stop to this heresy, and anchored the post-war world to institutions which depended on the dollar. Now the Chinese have expressed their concerns about the reliability of the dollar, and floated the idea of a 'super-sovereign reserve currency'. Clearly the Chinese intend to claim the honours for reviving the unalloyed wisdom of J. M. Keynes.

Whatever the truth of this matter, it remains at first blush unlikely that the Americans are going to meet the raising of this ghost with any enthusiasm. Over the decades they have threatened to die in the last ditch to prevent the rebirth of pure Keynesianism, and there is little evidence

Ken Coates is editor of The Spokesman.

that this response will not continue. But these are difficult times, and China's weight is getting ever heavier …

What is plain is that the institutions of the IMF will not be easy to rescue unless they are modified. Chinese resources will require Chinese influence, in considerable measure. If this does not happen then the joyful announcements about the impending Chinese rescue of the IMF may prove premature.

Zhou Xiaochuan, who is the governor of the People's Bank of China, has proposed measures to enhance the global role of Special Drawing Rights, amounting to a sweeping reform of the international monetary system. Mr. Zhou has received strong support from other Asian countries, and significantly from Brazil and Russia. But up to now, the United States has rejected the new proposals, and warned that they could undermine confidence in the dollar. However, the dollar is already weakened, and Chinese Premier Wen registered this weakness when he called for guarantees that China's vast dollar holdings would not be undermined.

Mr. Zhou's proposals would create open-ended Special Drawing Rights, which could be underpinned by the tottering dollar balances. Instead of converting the dollars, in which they were losing faith, through normal market channels, these dollars would be deposited in an IMF account for Special Drawing Rights. These would be liquid assets paying a market rate of return, and offering the necessary measures of diversification, since the SDR is denominated against a basket of currencies (44% Dollars, 34% Euros and 11% each of Yen and Sterling).

By these means, dollar holders would be offered prompt diversification, and avoid a freefall of the value of their holdings. Europe would be insured against destabilising rises in the Euro and a potential instability would be checked. The price for the Chinese would be substantial contributions to the new lending facilities, but Americans and Europeans would have to agree to a major rise in Chinese voting rights at the IMF. Historically the Europeans have been over-represented in that forum, but if there were to be a solid agreement between China and America, such a rebalancing of IMF decision-making could become irreversible.

The post-war political settlement, following 1945, endured on the political plane until 1989 and the rapid collapse of the Soviet Union and its alliances. The constitutional settlement still totters on, in the institutions of the United Nations. But the post-war economic settlement underwent a more ragged evolution. Today the reckoning looks more complex, and more disadvantageous to the powers in the West than ever seemed likely before. Revisions in the role of the IMF may be painful to negotiate, but these are going to be interesting times.