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NOTE

The Currency Report

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Many countries including Russia, Switzerland and Venezuela are withdrawing their foreign exchange reserves from the US dollar and investing in Japanese Yen or European Euro. Many countries want to exit from the US dollar. There is an eerie perception that the dollar may collapse any day and investors, private investors in particular, are withdrawing from the dollar before it collapses. The purchase of dollar is being made mostly by foreign governments like those of Japan, China and India. This purchase is motivated on the considerations of geopolitics since these governments do not want to find themselves on the wrong side of the world's only superpower. But to shift from dollar to Euro or Yen is like falling from the frying pan into the fire because the European and Japanese economies suffer from similar problems. For one thing rupee is a better candidate than these to take on the role of the world currency.

In an article titled "When Currency Empires Fall," Avinash Persuad of *Agora Financial*, Baltimore tells that the world reserve currency has changed many times: "International currencies in the past have included the Chinese liang and the Greek drachma coined in the fifth century BC; the silver punch-marked coins of fourth-century India; the Roman denari; the Byzantine solidus and Islamic dinar of the Middle Ages; the Venetian ducato of the Renaissance; the 17th-century Dutch guilder; and, of course, sterling -- and now the dollar." A study of literature and the history of these currencies indicates that the world currency must have four qualities : (1) It should be freely convertible; (2) It should be backed by a large economy; (3) The economy should be growing and leading the world; and (4) It should display sound economic management. These qualities were present in the British sterling in the nineteenth and twentieth centuries. But it became weak in the late twentieth century. The sterling remained fully convertible but the size of the British Empire shrank. England failed to make new technological innovations like those of the steam engine and canon it had made earlier. Britain ceased to lead the world economy. Its growth rate faltered. As a result countries pulled out of the sterling in the early part of the twentieth century. Britain made it compulsory for its colonies to hold their foreign exchange in sterling in order to bolster the currency. But, of course, such measures failed to stem the decline.

The condition of the US dollar is suspect presently. The share of dollar in world foreign exchange reserves is declining speedily. Surely, the dollar is fully convertible and the US remains the largest economy in the world but its growth rate is weakening. The share of the US in world income was about one-half at the end of the Second World War. It has now declined to about one-fourth. The US economy does not display sound economic management. Its trade and fiscal deficits are huge. It is spending huge amounts in wars in Vietnam, Afghanistan and Iraq much the way Britain indulged in militarism in the nineteenth and twentieth centuries. The US is borrowing money from the world through the sale of Treasury Bills and using that money to make wars or to increase consumption of its people instead of using it for investments. The US remains the technology leader but it has not made any decisive technological advance like the internet in the last decade. Whether Americans like it or not dollar is fast losing its status as the world currency which explains the anxiety of various countries to pull out of the dollar. Euro may provide safety but it lacks the strength to lead the world economy.

The second contender is the Chinese *Yuan*, also known as *Renminbi*. The growth rate of China is highest among the major countries of the world. But the *Yuan* is not fully convertible. The price of *Yuan* is determined less by the market and more by the perceptions of officials of Bank of China. China is also not the leader in technological developments nor is it a global financial centre. The global investor is not likely to invest in *Yuan* for these reasons.

The situation of the Indian rupee is better. It is moving fast towards full convertibility. India's share in world income is increasing fast though it is small presently. □□□