Descent of the Dollar and Rise of the Rest

JOSEPH STIGLITZ, *a former chief economist of the World Bank, was awarded the Nobel Prize for Economics in 2001. He spoke with* NPQ *on Monday, April 20.*

NPQ | Former United States Treasury Secretary Hank Paulson has argued that one of the key dynamics of the credit bubble was the massive availability of Chinese liquidity to America through investing their dollar reserves in US government securities. This kept long-term interest rates down, making credit easy and also prompting investors to "reach for yield" in more exotic instruments. Do you agree with that analysis?

JOSEPH STIGLITZ | Yes and no. It is true that Chinese savings were flowing massively into the US and, obviously, interest rates in the US were affected, but by no means determined, by that. The overall high level of liquidity could have been undone by the Federal Reserve, which had discretion over interest rates. It could have raised them to slow down the bubble caused by easy credit expansion.

Usually, a wealth of savings is a blessing, not a problem. Having cheap money is a basis of strong economic growth. The problem is that the American financial system didn't do what it was supposed to do—which is manage risk and allocate capital to productive ends. We literally wasted that blessing and are now paying the price. But it is absurd to blame the Chinese.

NPQ | Among Obama's many challenges, isn't the overarching one correcting this imbalance in savings and consumption between the US and China?

STIGLITZ | In a globally integrated economy, the biggest challenge is to make sure there is adequate global aggregate demand, achieved through spending, when countries like China feel they must save high levels of dollar reserves to protect against international currency volatility.

After all, China's accumulation of reserves is a result of the IMF's mismanagement of the Asian financial crisis a decade or so ago. If countries know they can't rely on the IMF to help them, their best defense is their own reserve cushion. In a time of spreading global recession, too much emphasis on savings in surplus countries like China can impede prospects for global growth.

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NPQ | Getting worried over the value of their billion-plus holdings in dollars as US deficits mount and inflation threatens down the road, the Chinese have proposed a new global reserve currency based on a basket of currencies instead of just the dollar. Is such a new currency a good mechanism for undoing the imbalance with a soft landing instead of the crash of the dollar, which would hurt the Chinese as well as the US?

A new basket reserve currency would stimulate global aggregate demand by vastly reducing the fear of currency volatility, which, as I said, is what has led countries like China to put away so much money in reserves instead of spend it.

STIGLITZ | The proposal for a new global reserve currency—or Special Drawing Rights (SDR)—is a good idea for many reasons. Yes, for the Chinese it would cushion any fall in the value of the dollar per se because it would only be part of a basket of other currencies, including the yen and the euro. But, above all, a new basket reserve currency would stimulate global aggregate demand by vastly reducing the fear of currency volatility, which, as I said, is what has led countries like China to put away so much money in reserves instead of spend it.

There are other benefits. As a matter of sound economics, the well-being of the world should not depend on the management of a single currency. Currency risk would be diversified through a basket reserve unit, creating stability and confidence all around. Finally, there is an equity issue. Because the dollar is the reserve currency of the world, especially in a downturn where investors flee to safety, the US can suck up the savings of the rest of the world even though the interest rates it pays are near zero. That would not happen if there were a global basket reserve currency.

NPQ | What would it mean for the US if the dollar were replaced by a new global currency?

STIGLITZ | Actually, it would be very much in the long-term interest of the US because it would help de-financialize the American economy. Of course, the US gets a bit of a break by being able to borrow at low costs from the rest of the world. But that comes at a macroeconomic cost at home. One way of looking at it is that the US has turned to exporting T-bills instead of automobiles or other commodities. Global demand for dollars has supplanted demand for manufactured goods and services, resulting in multilateral trade deficits and loss of jobs at home.

NPQ | At their summit in London recently, the G-20 leaders decided to create $250 billion in new SDR. Is that an important step on the way to creating a new global reserve currency?

STIGLITZ | I think it is. The question is how quickly it happens. In my view, though, the IMF is not the best place from which to launch this currency unless it becomes a more fair and balanced institution that represents the real world economy instead of the post-World War II powers, dominated by the US. The East Asian countries, Brazil and others need a much greater say.

For example, of the $250 billion in SDR committed, only $19 billion was allocated for developing countries. So, the idea of greater SDR is a good one. The institution is flawed.

NPQ | Even so, the fact that the Chinese have proposed a new global SDR currency and the G-20 has taken a step toward its creation surely marks a powershift in the world?

STIGLITZ | Without question, it is a recognition of the reality of a genuinely multipolar world that requires moving to a genuinely multilateral system of governance. The powershift began already several years ago, under the Bush administration, when the dollar became very volatile and started declining. That is when China shifted from having almost 100 percent of its reserves in dollars to 75 percent. Some countries went completely out of the dollar. The dollar, for all intents and purposes, lost its special reserve status and people starting talking about a portfolio, or basket, approach as a store of wealth instead of the dollar.

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The Free-Market Economy Is Fundametally Healthy

At the Milken Global Conference in April, three Noble Laureates in Economics sat down to discuss the global recession. **GARY BECKER,** *awarded the Nobel Prize in 1992, is a professor of economics and sociology at the University of Chicago.* **ROGER MYERSON,** *also a professor of economics at the University of Chicago, was awarded the Nobel Prize in 2007.* **MYRON SCHOLES,** *chairman of Platinum Asset Management, was awarded the Nobel Prize in 1997.*

GARY BECKER | One of the depressing things about much of the economic commentary today is the insistent comparisons of this crisis to the Great Depression. There is no comparison.

Of 80 million homes in America today, 27 million do not have mortgages because they are fully owned. Forty-six million mortgage holders are paying on

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