Monetary Sovereignty as Globalization's Achilles' Heel

Benn Steil

It is remarkable how the world's short recent history of floating exchange rates among fiat currencies has affected popular thinking about what is eternally normal and proper in the economic system. Recently, Senators Charles Schumer and Lindsey Graham (2006) wrote matter of factly in the *Wall Street Journal* that "One of the fundamental tenets of free trade is that currencies should float." Such a "tenet," if it were such, could only have emerged since the 1970s. Of course, exchange rates had fluctuated widely in previous centuries, but it has been only since the 1970s that such fluctuations have been taken as connatural with the international monetary regime. Even John Maynard Keynes, the arch slayer of the last remnants of commodity money, was an adamant supporter of fixed exchange rates.[1]

Before the 1970s, it was generally taken for granted that international transactions would be best served by a system of fixed exchange rates relative to the international standard of value, which was a commodity or a claim on a commodity. Money accepted across borders had generally been gold, or claims on gold, for about 2,500 years. The post-1971 international monetary "system," certainly a misnomer, is comprised of 150-some-odd currencies, primarily national, all circulating in the form of irredeemable IOUs, or IOUs redeemable only in other IOUs. Some trade freely against others, some trade freely but with governments buying and selling so as to maintain a desired price, and some are subject to exchange restrictions by their government issuers. This would appear a recipe for continual global chaos, but it functions with far more stability than one might expect, given the complete absence of agreed rules or an agreed international

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Benn Steil is Director of International Economics at the Council on Foreign Relations.

[1]Keynes laid out conditions under which "structural disequilibrium" merited changing parities, but he did not support floating, as claimed by Martin Wolf and others.

money. This is because one currency, the U.S. dollar, is widely accepted voluntarily as money for the purposes of international transactions.

Nonetheless, it is a source of tremendous periodic instability, manifesting itself in currency crises afflicting countries whose currencies are not acceptable for international transactions, but which build up currency imbalances in their national balance sheets through their imports of dollar capital. Over the past two decades, devastating currency crises have hit such countries across Latin America and Asia, as well as countries just beyond the borders of western Europe; in particular, Russia and Turkey. This has led to international capital flows becoming far and away the most widely condemned flaw in globalization.

That the destabilizing effects of today's cross-border capital flows should be considered, however, even by economists who should know better, a manifestation of "market imperfection" or "irrationality" is to my mind astounding. The fundamental difference between capital flows under indelibly fixed and non-fixed exchange rates was well known generations ago, decades before the modern era of globalization. Consider this excerpt from a lecture by Friedrich Hayek in 1937:

> Where the possible fluctuations of exchange rates are confined to narrow limits above and below a fixed point, as between the two gold points, the effect of short-term capital movements will be on the whole to reduce the amplitude of the actual fluctuations, since every movement away from the fixed point will as a rule create the expectation that it will soon be reversed. That is, short-term capital movements will on the whole tend to relieve the strain set up by the original cause of a temporarily adverse balance of payments. If exchanges, however, are variable, the capital movements will tend to work in the same direction as the original cause and thereby to intensify it [Hayek 1937: 64].

This was because

> Every suspicion that exchange rates were likely to change in the near future would create an additional powerful motive for shifting funds from the country whose currency was likely to fall or to the country whose currency was likely to rise. I should have thought that the experience of the whole post-[first world] war period and particularly of the last few years had so amply confirmed what one might expect *a priori* that there could be no reasonable doubt about this [Hayek 1937: 63–64].

Hayek's logic was mirrored precisely by the radical change in capital flow behavior that accompanied the crumbling of a credible international monetary anchor, gold, between the first and second world wars. In the words of Ragnar Nurkse (1944: 29),

> After the monetary upheavals of the [first world] war and early post-war years, private short-term capital movements tended frequently to be disequilibrating rather than equilibrating: a depreciation of the exchange or a rise in discount rates, for example, instead of attracting short-term balances from abroad, tended sometimes to affect people's anticipation in such a way as to produce the opposite result. In these circumstances the provision of the equilibrating capital movements required for the maintenance of exchange stability devolved more largely on the central banks and necessitated a larger volume of official foreign exchange holdings.

This is not simply a matter of whether exchange rates are "fixed" or floating. Exchange rates were "fixed" within the European Monetary System in the late 20th century, but capital flows served to *destabilize* rather than stabilize it. Interest rate increases will not automatically attract capital flows where the credibility of the fixed parity is inherently weak. This goes to the heart of the difference between the classical gold standard and fixed exchange rates among fiat currencies: the former was based on a highly credible commodity standard in which the market, rather than government, determined the money stock, whereas the latter is based on an agreement between fiat money issuers, each of which faces incentives to manipulate the money stock in a way which undermines the exchange rate commitment (see Cesarano 2006). The presence of active monetary policymakers will invariably undermine the stabilizing tendency of capital flows.

Yet, perversely as a matter of both monetary logic and history, the most notable economist critic of globalization, Joseph Stiglitz, has argued passionately for monetary nationalism as the *remedy* for the economic chaos of currency crises (see Stiglitz 2002, 2005). When millions of people, locals and foreigners, are selling a national currency in fear of impending default, the Stiglitz solution is for the issuing government simply to decouple from the world: lower interest rates, devalue, close off financial flows, and stiff the lenders. It is precisely this thinking, a throwback to the disastrous 1930s, which is at the root of the cycle of crisis that has infected modern globalization. Again, Hayek foresaw it in 1937:

> The modern idea apparently is that never under any circumstance must an outflow of capital be allowed to raise interest rates at home, and the advocates of this view seem to be satisfied that if the central banks are not committed to maintain a particular parity they will have no difficulty either in preventing an outflow of capital

> altogether or in offsetting its effect by substituting additional bank credit for the funds which have left the country.
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> It is not easy to see on what this confidence is founded. So long as the outward flow of capital is not effectively prevented by other means, a persistent effort to keep interest rates low can only have the effect of prolonging this tendency indefinitely and of bringing about a continuous and progressive fall of the exchanges. Whether the outward flow of capital starts with a withdrawal of balances held in the country by foreigners, or with an attempt on the parts of nationals of the country to acquire assets abroad, it will deprive banking institutions at home of funds which they were able to lend, and at the same time lower the exchanges. If the central bank succeeds in keeping interest rates low in the first instance by substituting new credits for the capital which has left the country, it will not only perpetuate the conditions under which the export of capital has been attractive; the effect of capital exports on the rates of exchange will, as we have seen, tend to become self-inflammatory and a "flight of capital" will set in. At the same time the rise of prices at home will increase the demand for loans because it means an increase in the "real" rate of profit. And the adverse balance of trade which must necessarily continue while part of the receipts from exports is used to repay loans or to make loans abroad, means that the supply of real capital and therefore the "natural" or "equilibrium" rate of interest in the country will rise. It is clear that under such conditions the central bank could not, merely by keeping its discount rate low, prevent a rise of interest rates without at the same time bringing about a major inflation [Hayek 1937: 65–66].

Hayek goes on to explain how the monetary nationalists must then inevitably argue for capital controls, as Stiglitz has of course done, in order to stop the people from disturbing the government's control of national credit conditions. But the government cannot stop there, as "exchange control designed to prevent effectively the outflow of capital would really have to involve a complete control of foreign trade, since of course any variation in the terms of credit on exports or imports means an international capital movement" (Hayek 1937: 67).

Indeed, this is precisely what the Argentine government has been doing since abandoning its dollar currency board in 2002. Since writing off $80 billion worth, or 75 percent in nominal terms, of its debts, the government has been resorting to ever-more intrusive means in order to counteract the ability of its citizens to protect what remains of their savings and to buy or sell with foreigners.

In 2003, the Argentine government introduced capital controls and domestic price controls, targeting the energy sector. The goal was to keep the exchange rate from rising in order to "maintain export competitiveness" while simultaneously containing the inflation that policy was giving rise to.

In 2004, energy sector controls were extended to include export taxes on crude oil, in order to "insulate the domestic price from the full effect of international fluctuations," in the words of the economy minister, and partial export bans were imposed on natural gas and oil. President Kirchner excoriated gas and oil companies for "underinvestment," though investment was irrational given the price controls. The government founded a state energy company, Enarsa, which it was then able to order to undertake unprofitable investments. The government also began the first of its major attacks on foreign investors, repealing a 1997 airwave licensing contract with a French company, Thales Spectrum, declaring the pre-crisis privatizations to have been a failure.

In 2005, President Kirchner called for a nationwide boycott of Shell after it raised Argentine oil prices in line with global oil prices. French company Suez announced it was leaving the country, selling its controlling share in Aguas Argentina, the Buenos Aires water supplier, after years of losses following a 2001 freeze in utility prices. New currency rules were imposed, forcing companies to convert most foreign proceeds into pesos and limiting the amount of foreign currency that individuals could acquire to invest abroad. Government price controls were extended throughout the economy. President Kirchner attacked supermarkets for rising inflation, which had surpassed 12 percent, demanding that they accept "voluntary" price controls. Incoming economy minister Felisa Miceli dismissed her predecessor's concerns about rising inflation as "an argument to maintain low wages." She announced that she would not resort to "orthodox methods" of inflation control, such as tightening money supply or raising interest rates.

In 2006, President Kirchner expanded his price control campaign to foreign consumer goods companies, summoning executives from Proctor & Gamble, Unilever, and Kimberly-Clark to demand that they stop raising prices. Targeted companies complied by reducing the size of their products, thus raising unit price without raising the shelf price. Local textile companies were next in line, being forced to sign an agreement with the government pledging a price freeze. In an effort to hold the official inflation rate at 1 percent per month, President Kirchner then called for "voluntary" price freezes on about 300 products, such as sugar, flour, noodles, bread, shampoo, and pencils, targeting particularly component products of the official consumer price index. Beef exports were also banned in an attempt to increase domestic supply, but this had the effect of exacerbating the trend of Argentine landowners converting cattle pastures to soya bean fields. "Voluntary" price control agreements were further extended to items as diverse as medicines and private school tuitions. In October, President Kirchner announced that price controls expiring at the end of 2006 would be extended until the end of 2007, just after the scheduled autumn presidential election. Meanwhile, economists not employed at the president's pleasure estimate that monthly inflation has risen to 1.5–2 percent.

What used to be the most cosmopolitan nation in Latin America is now following the Stiglitz path of monetary nationalism religiously. And the results, when crises spread yet again to the likes of Brazil, Turkey, Indonesia, and other countries struggling to reconcile monetary nationalism with globalization, will almost certainly be as ordained by Hayek (1937: 71–72):

> It is an illusion that it would be possible, while remaining a member of the international commercial community, to prevent disturbances from the national monetary policy such as would be indicated if the country were a closed community. It is for this reason that the ideology of Monetary Nationalism has proved, and if it remains influential will prove to an even greater extent in the future, to be one of the main forces destroying what remnants of an international economic system we still have . . . .
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> But even more serious seem to me the political effects of the intensification of the differences in the standard of life between different countries to which it [will] lead. It does not need much imagination to visualize the new sources of international friction which such a situation would create.

Argentina could not be a more fitting fulfillment of Hayek's fears. Since the 2002 devaluation, the Argentine government has been in continuous conflict with its European counterparts over the expropriations imposed on the latter's bondholders and corporate direct investors, and the population has turned viscerally anti-American, anti-IMF, and anti-globalization.

Globalization under the Gold Standard

Capital exports from western Europe in the late 19th and early 20th centuries were enormous by historical metrics, notwithstanding the hyperbole lavished on today's "global capital" by its fans and detractors. Mean current account surpluses and deficits as a percentage of GDP in 1880 were roughly twice as high as they are today. British net foreign investment reached 7.7 percent of GDP in 1872, and a high of 8.7 percent in 1911—nearly twice Japan and Germany's peaks in the late 1980s. Most of this was portfolio investment—stocks and bonds; 79 percent for Latin America, and 85 percent for North America and Australia in 1913. And most of the debt held was government-issued, as it is today for most of the developing world's foreign-held debt. Studies have also shown that domestic investment was less constrained by domestic savings, meaning that capital flows were doing more of the job of matching available capital to investment needs than they are today (O'Rourke and Williamson 1999).

Purchasing power parity, measured according to wholesale (i.e., tradable goods) prices, and equalization of real interest rates across the world held to a degree not seen previously or since (McKinnon 1993). Commodity prices were aligned internationally about as well as they were across regions within countries (McCloskey and Richard 1976). Today, in contrast, we are so accustomed to a world of autarkic national currencies that we consider it right and normal not for commodity prices to align internationally, but for the *entire structure of prices* in each country to shift up and down, often dramatically, against the entire structure of other countries' prices. Thus a fall in the global (dollar) price of a commodity like coffee tends not to produce necessary diversification away from inefficient types of coffee production, but rather an engineered economy-wide inflation and devaluation in countries in which coffee exporters are politically powerful. The coffee price fails to perform its function of adapting coffee supply to demand; rather, the central bank distorts all other prices in the economy to prevent adaptation. This practice, virtually unique to the late 20th century, is at the root of development stagnation for so many poorer countries.

There are many reasons why economies became dramatically more integrated after 1870, both within and across countries. Among these are tremendous technological advances in transportation and communication, particularly the railroad, steamship, telegraph, cable, and refrigeration. The spread of free-trade thinking from Britain to the European continent, underpinned by vested interests in Germany and France which saw greater export opportunities afforded through trade liberalization, also contributed to large declines in some import tariffs. But the disintegration of markets internationally, particularly capital markets, coincided strongly with the tribulations and eventual collapse of the classical gold standard after 1914. The heyday of globalization was an historical period in which monetary nationalism was widely seen as a sign of backwardness; adherence to a universally acknowledged standard of value a sign of abiding among the civilized nations. And those nations that adhered most reliably to the gold standard (such as Canada, Australia, and the United States) paid lower borrowing rates in the international capital markets than those that adhered less (such as Argentina, Brazil, and Chile) (Bordo and Rockoff 1996). The gold standard not only reduced exchange risk, but country default risk. The evidence suggests strongly that being on the gold standard represented the most credible form of commitment to pursuing prudent fiscal and monetary policies over time, given the ever-present temptation to inflate away the burden of debt and manufacture seigniorage revenues.

As notable an opponent of the gold standard as Karl Polanyi took it as obvious that monetary sovereignty was incompatible with globalization. Focusing on 19th century Britain's interest in growing world trade, he stated that "nothing else but commodity money could serve this end for the obvious reason that token money, whether bank or fiat, cannot circulate on foreign soil. Hence the gold standard—the accepted name for a system of international commodity money—came to the fore" (Polanyi 1944). Yet what Polanyi considered nonsensical—global trade in goods, services, and capital intermediated by national token monies—is exactly the way in which globalization is advancing today. And national token monies, I would argue, have turned out to be the Achilles' heel of globalization. Were it not for the regular recurrence of devastating national financial crises, of which token monies in open economies are the root cause, resistance to globalization would be far less virulent and carry far less resonance.

To be sure, financial crises were not invented in the late 20th century. They did occur under the 19th century gold standard, but the credibility of the Bank of England's commitment to convertibility meant that short-term capital flows actually played a highly *stabilizing* role, allowing rapid adjustment to balance-of-payment disturbances through interest-rate arbitrage: trade deficits not offset by an inflow of long-term capital could be reliably financed by short-term inflows stimulated by a modest rise in short-term interest rates (McKinnon 1993). The cross-border flow of gold itself was peripheral to the adjustment mechanism. Given how commonplace is the perception today that short-term capital flows are *inherently* destabilizing, the lessons of the gold-based globalization era simply must be relearned. Just as the prodigious daily capital flows between New York and California are so uneventful that no one even comments on them, capital flows between countries sharing a single currency, such as the dollar or the euro, or using currencies which are merely claims on gold, as in the 19th century, attract not the slightest attention from even the most passionate anti-globalization activists.

Globalization and Monetary Sovereignty

The financial crises of 1995–2002 convinced much of the economics profession that only "corner solutions" were sustainable as exchange rate policies: that is, countries should either float or "dollarize." Central banking itself must ultimately succumb to such logic. Increasingly, room for central bank discretion will become so tightly constrained by competition from foreign central bank monies, or perhaps even emerging privately managed commodity monies (see below), that central banks will become little more than seigniorage vehicles for their governments, or governments will have to apply ever more repressive techniques to prevent their citizens from using alternatives (witness post-devaluation Argentina). This is another way of saying that globalization and monetary sovereignty are incompatible. Either the mythology of money reverts to its medieval form—the high middle ages being a time in which popes condemned debasements, and money was understood as a manifestation of morality and trust in interpersonal dealings—and states abandon central banking to accommodate globally accepted monies (such as the dollar, the euro, or gold), or the mythology remains as it has metastasized since the 1970s, with money as a manifestation of state sovereignty, in which case capital flows will continue to destabilize rather than stabilize commerce, and globalization will increasingly be portrayed popularly as an intrinsically hostile force.

I contrast what I term the "mythology" of money, which has metamorphosed over history in tandem with religious and political thought, and the psychology of money, which is constant. Myths are shared popular beliefs over ideals, which need not be accepted as true in an empirical sense in order to compel desires and behavior. A Latin American may oppose dollarization and international capital flows as violations of state sovereignty while simultaneously demanding dollars in payment and sending them abroad for safekeeping. Here, myth and psychology clash.

No one has illuminated the psychology of money more compellingly than the eminent German sociologist and philosopher Georg Simmel. If we wish to make sense of the role of money in late 19th century globalization, Simmel or Polanyi's accounts will do equally well. But if we wish to make sense of its role in late 20th century globalization, only Simmel's account will do.

"The spread of trade relations," Simmel (1900: 181) argued, "requires a valuable currency, if only because the transportation of money over long distances makes it desirable that the value should be concentrated in a small volume. Thus, the historical empires and the trading states with extensive markets were always driven towards money with high material value," such as gold. "When the scope of trading expands," he continued, "the currency also has to be made acceptable and tempting to foreigners and to trading partners," something which is missing in most of the world today—a world in which only dollars and a handful of alternatives have achieved acceptability.

> The extension of the economic area leads, *ceteris paribus*, to a reduction of direct contact; the reciprocal knowledge of conditions becomes less complete, confidence more limited, and the possibility of getting claims satisfied is less certain. Under such conditions, no one will supply commodities if the money given in exchange can be used only in the territory of the buyer and is of doubtful value elsewhere. The seller will demand money that is valuable in itself, that is to say accepted everywhere. The increase in the material value of money signifies the extension of the circle of subjects in which it is generally accepted, while in a smaller circle its negotiability may be secured by social, legal and personal guarantees and relationships [Simmel 1900: 181–82].

Polanyi would have agreed, and, equating gold with material value, concluded that gold was a necessary, albeit undesirable, foundation for widespread international trade. Here Simmel departs from Polanyi, presaging the emergence nearly a century later of a global fiat money, the U.S. dollar, which would engender widespread confidence even in the absence of any material value.

> If we suppose that the usefulness of money is the reason for its acceptance, its material value may be regarded as a pledge for that usefulness; it may have a zero value if negotiability is assured by other means, and it will be high when the risk is great. However, expanding economic relations eventually produce in the enlarged, and finally international, circle the same features that originally characterized only closed groups; economic and legal conditions overcome the spatial separation more and more, and they come to operate just as reliably, precisely and predictably over a great distance as they did previously in local communities. To the extent that this happens, the pledge, that is the intrinsic value of the money, can be reduced . . . Even though we are still far from having a close and reliable relationship within or between nations, the trend is undoubtedly in that direction. The association and unification of constantly expanding social groups, supported by laws, customs and interests, is the basis for the diminishing intrinsic value of money and its replacement by functional value [Simmel 1900: 182].

Simmel correctly adjudged that ever closer interactions among people living in far-flung states would lead to a convergence of expectations and interests that would eventually pave the way for international money divorced from gold. This mass psychology is as much to be desired for its political benefits as for its economic benefits, for, as Simmel argues, money is a "reified social function," a physical representation of a voluntary bonding among individuals, and the exchange it facilitates is a *creator* of such bonds rather than a result of them:

> The function of exchange, as a direct interaction between individuals, becomes crystallized in the form of money as an independent structure. The exchange of products of labour, or of any other possessions, is obviously one of the purest and most primitive forms of human socialization; not in the sense that "society" already existed and then brought about acts of exchange but, on the contrary, that exchange is one of the functions that creates an inner bond between men—a society, in place of a mere collection of individuals [Simmel 1900: 175].

This is perhaps one of the most eloquent expressions of the desirability of globalization ever written. The ability of people to enter into freely sought exchanges is what makes of them a society—rather than a family, on the one hand, or a mere assortment of individuals on the other—and people who perceive themselves to be part of a common society are more likely to behave cooperatively and less likely to address differences through violence. Unfortunately, the myth of monetary sovereignty, which we who were raised in a world of national fiat currencies have all come to share to a greater or lesser degree in spite of our deeper psychological impulses which contradict it, too often functions to bar the political way forward.

The Dollar's Destiny

The precariousness of the dollar's position today is, interestingly enough, captured vividly by the brilliant French economist Jacques Rueff, writing in 1965, a half-decade before the collapse of the Bretton Woods dollar-based gold-exchange standard:

> The gold-exchange standard attains such a degree of absurdity that no human brain having the power to reason can defend it. What is the essence of the regime, and what is its difference from the gold standard? It is that when a country with a key currency has a deficit in its balance of payments—that is to say, the United States, for example—it pays the creditor country dollars, which end up with its central bank. But the dollars are of no use in Bonn, or in Tokyo, or in Paris. The very same day, they are re-lent to the New York money market, so that they return to the place of origin. Thus the debtor country does not lose what the creditor country has gained. So the key-currency country never feels the effect of a deficit in its balance of payments. And the main consequence is that there is no reason whatever for the deficit to disappear, because it does not appear. Let me be more positive: if I had an agreement with my tailor that whatever money I pay him he returns to me the very same day as

> a loan, I would have no objection at all to ordering more suits from him [Rueff and Hirsch 1965: 2–3].

Today, with the U.S. current account deficit running at well over 6 percent of GDP, necessitating the import of about $2 billion a day to sustain, the United States is in the fortunate position of the suit-buyer whose Chinese tailor instantaneously returns all his payments in the form of a loan—generally purchases of U.S. treasury bonds. The current account deficit is partially fuelled by the budget deficit (elasticity estimates generally range from 20–50 percent), which will soar in the next decade in the absence of reforms to curtail federal "entitlement" spending on medical care and retirement benefits. The United States—and indeed the Chinese tailor—must therefore be concerned with the sustainability of what Rueff called an "absurdity." In the absence of restored fiscal prudence, the United States risks undermining the faith foreigners have placed in its management of the dollar—that it can continue to sustain low inflation without having to resort to growth-crushing interest rate hikes as a means of ensuring continued high capital inflows. It is widely assumed that the natural alternative to the dollar as a global currency is the euro, but faith in the euro's endurance is fragile at the present time—undermined by the same fiscal concerns that afflict the United States, but with the added angst deriving from concerns about the temptations faced by Italy and others to return to monetary sovereignty as a means of restoring the ability to devalue. But there is another alternative—the world's most enduring—gold (Steil 2007).

A revived gold standard, I should emphasize, is politically infeasible—not merely its establishment, given the political power of contemporary central banks, but its sustainability were it to be established. The 19th century gold standard operated in a world where governments spent less than 10 percent of national income. "Fiscal policy" was almost meaningless in such a world. In our world, in which governments spend half or more of national income, the government sector is so large as to be incapable of subordinating its money flows to an international commodity rule. A private gold-based monetary system, however, is a very different proposition.

At present, Americans and non-Americans alike make and receive international payments in dollars because they have confidence that dollars will, relative to other transaction vehicles, retain their value well in future commercial transactions. It is hardly science fiction to imagine a tomorrow in which this is no longer the case. Some have already imagined it, and are living it. There already exist e-money firms that manage investment accounts denominated in gold and intermediate payments in gold across account holders, which are generally small companies doing international transactions. These "gold banks" hold physical gold bars in a vault, and account holders acquire and exchange digitized legal claims to fractions of these bars. Of course, clients must bear the cost of storing the gold. But at generally less than 1 percent a year, this cost compares remarkably favorably with the inflation cost imposed by almost all the world's central banks. While certainly a niche business at present, digital gold has grown dramatically over the past several years, in tandem with the dollar's decline against gold.[2]

Could the masses come to trust a privately managed gold money system? To date, they have never been asked to trust a publicly managed fiat money system—they have merely been obliged to live with it, often at the cost of having their savings and livelihoods repeatedly decimated by inflation and devaluation. As French economist Charles Rist wrote in 1934, the move away from gold was accomplished in the face of considerable public resistance:

> A wider and wider gap is opening every day between this deep-rooted conviction [in gold as the only safe store of wealth] on the part of the public and the disquisitions of those theoretical economists who are representing gold as an outworn standard. While the theorizers are trying to persuade the public and the various governments that a minimum quantity of gold—just enough to take care of settlements of international balances—would suffice to maintain monetary confidence, and that anyhow paper currency, even fiat currency, would amply meet all needs, the public in all countries is busily hoarding all the national currencies which are supposed to be convertible into gold.

Contract law and competition can provide some security against fraud or mismanagement in a private digital gold system, whereas contract law is nonexistent in the case of inflation-racked fiat systems, and competition is feasible only for the wealthy elites who have access (frequently illegal) to foreign assets. Georg Simmel commented with characteristic insight and foresight at the turn of the 20th century, when gold was the firm foundation of the international monetary system, that "although money with no intrinsic value would be the best means of exchange in an ideal social order, until that point is reached the most satisfactory form of money may be that which is bound to a material substance" (Simmel 1900: 191). Today, with money bound to no material substance, it is worth reflecting upon the

[2]See, for example, "Would You Like to Pay by Check, Cash—or Gold?" (2005). The article focuses on one such company, GoldMoney.com.

degree to which our world approximates the "ideal social order" that can sustain such a system.

What Now?

It was well understood before the Bretton Woods era that monetary nationalism would fundamentally change the way capital flows naturally operate, making of a benign economic force one which would necessarily wreak havoc with flexible exchange rates. But that understanding has been all but lost. The global monetary order that has emerged since the 1970s is now globalization's greatest source of vulnerability. Capital flows have come to be seen as *inherently* destabilizing, and the anti-market animus this perception encourages will only grow more potent as currency crises recur, or governments resort to ever-more draconian interventions in the working of the price system in order to forestall them.

What is to be done? An effective cooperative solution is difficult to imagine. The genie of fiat money cannot be put back into the bottle. Realistically, therefore, "*sauve qui peut*" is the message for nations whose currencies are not wanted by foreigners. Dollarization—abandonment of parochial currencies in favor of the dollar, euro, or other internationally accepted money—is, in a world of fiat currencies, the only way to globalize safely. Of course, the status of global money is not heaven-bestowed, and there is no way effectively to insure against the unwinding of "global imbalances" should China, with more than a trillion dollars of reserves, and other asset-rich central banks come to fear the unbearable lightness of their fiat holdings. Digitized commodity money may then be in store for us. As radical and implausible as that may sound, digitizing the earth's 2,500-year experiment with commodity money may ultimately prove far more sustainable than our recent 35-year experiment with monetary sovereignty.

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