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Dealing with outdated global currency exchange system

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Trade is an engine of growth throughout the world in these days of globalisation and opening up of the market. Over the past 20 years, the growth of world trade has averaged 6.0 per cent per year, twice as fast as world output. Due to globalisation and simplification of rules, the cross-border trade is growing very fast and has become vital for many economies. It has further got importance due to integration of industries and specialisation of production in different parts of the world. The economies are linked into global supply chain of various products in different countries. Integration into the world economy has proven to be a powerful means for countries to promote economic growth, development, and poverty reduction. There is a huge trade of primary, intermediate and finished goods and services being transferred from one country to another.

The very lifeblood of the system of international exchange rate and currency stability can be enhanced by helping traders protect trade benefits achieved at the time of contracting. Foreign exchange rate fluctuation is one of the risks of selling internationally. The magnitude of this problem can be understood by looking at the average profit-to-turnover ratio for Fortune 500 companies, which in recent years has averaged around 7.0 per cent. When, in the same period, fluctuations in currencies of importance to the international monetary system have exceeded 7.0 per cent, often by several times, it becomes clear that such fluctuations are a major bottleneck to expanding trade and investment between monetary systems. The exchange rate risk/cost associated with expanding business internationally simply exceeds the potential profit.

Currency exchange rates are influenced by a variety of factors including supply and demand, interest rate differentials, economic news, political events and government intervention. There is no single entity that regulates or controls the foreign exchange market. Depending on whether the sale is denominated in the buyer's or the seller's currency, the buyer or the seller may incur additional costs (or lost profits) if the relative value of the two currencies changes between the time the goods are sold and the time the goods are paid for. In global transactions, buyers and sellers rarely use the same currency, and the relative value of their respective currencies constantly changes. For this reason, a decision to accept payment in a foreign currency can harm the seller's profit margin.

For many centuries, the gold standard exchange was the guarantee of stable exchange rate for international trade. The countries issue paper currencies against stocks of gold. The main feature of the gold exchange standard is that the government guarantees a fixed exchange rate to the currency of another country that uses a gold standard (specie or bullion), regardless of what type of notes or coins are used as a means of exchange. The most significant was the unilateral cancellation of direct convertibility of the US dollar to gold and most nations abandoned the gold standard as the basis of their monetary systems at some point of time to overcome recession in the US economy.

The idea of Special Drawing Rights (SDR), supplementary foreign-exchange reserve asset, defined and maintained by the International Monetary Fund (IMF), was evaluated as a substitute for gold and dollar. The SDR was created by the IMF in 1969 to support the Bretton Woods fixed exchange rate system. A country participating in this system needed official reserves-government or central bank holdings of gold and widely accepted foreign currencies-that could be used to purchase domestic currency in foreign exchange markets, as required to maintain its exchange rate. Only a few years after the creation of SDRs, the Bretton Woods system collapsed and the major currencies shifted to a floating exchange rate regime.

A floating exchange rate or fluctuating exchange rate is a type of exchange rate regime in which a currency's value is allowed to fluctuate in response to foreign-exchange market mechanisms. Global currency markets are in constant turmoil. The exchange rate of one currency versus the other is influenced by numerous fundamental and technical factors. These include relative supply and demand of the two currencies, economic performance, outlook for inflation, interest rate differentials, capital flows, technical support and resistance levels, and so on. There is an option of hedging to cover up possible loss from currency fluctuation but it is against costly insurance coverage.

While there have been attempts throughout history to build some degree of stability into the international monetary system, all these ultimately foundered. The current global currency exchange system is outdated; therefore, a new approach to exchange rates should be considered, including 'equilibrium' exchange rates to correct imbalances in the world's monetary system. The exchange rate system is one that has not had a major update for many years and unable to meet the demand for efficiency from its global users in the present global market situation.

There are other ideas to promote stability that don't require US buy-in, including a plan laid out by a Denmark-based group called Global Currency Union (GCU) and its innovative multi-currency exchange rate and settlement mechanism. Under a new proposed GCU, the two parties in international trade transact in their own currencies but their contract is denominated in 'global currency units' whose value is determined by a unique Index Key based on a weighted basket of currencies. Because of counterbalancing and risk-spreading qualities in the currency relationships within that basket, the Index Key sharply lowers the prospective exchange rate volatility for the two parties to the contract.

The Index Key for a given country is determined by: 1) identifying the country's primary trading partners, 2) making a selection of primary currencies and determining their relative weight to each other, 3) setting the Index Key by using the weight of each currency to determine the number of currency units which the weight corresponds to, and 4) given the Index Key (which sets the unique relations between trade-relevant currencies), the exchange rates towards any other currency can be set. With this index, the excessive movement in the exchange rates is balanced out and subdued by the currencies in the system.

The use of the GCU will promote a core value of increased stability, both when the exchange rate goes up and when it goes down, so that competitiveness is not suddenly eroded by a higher exchange rate, nor does expected income suffer when a reference currency moves lower. Such stability will enhance opportunities for economic growth. The GCU provides a level- playing field for an equal and fair division of the risks associated with changes in currency values. It absorbs much of that associated risk, and for that, it provides a mechanism for sharing such exchange rate risk between trading partners. It introduces a new aspect of fairness when settling international contracts with the exchange rate risk split among the parties to a contract as they best see fit. A self-balancing market-determined system, it ensures adjustment to ongoing changes in both currency values and trade patterns, thus ensuring optimal stability for the country that employs it without requiring the sort of interventions demanded by a pegged or managed exchange rate regime.

The system requires no intervention from the central bank to maintain optimal stability. But the confidence in the GCU system would be enhanced by association with governments and central banks. The GCU is a tool for helping define stable 'units of value' for practical use, but its reference points are real currencies issued by states. For this reason alone, policy input and a degree of oversight by states would ensure that the system supports and functions within emerging policy, legal and regulatory frameworks, and that the GCU continues to serve its trade-enhancing function, at no cost and with a clear means for national states to voluntarily associate with its work mechanisms.

Bangladesh's international trade is transacted in US dollar which has floating exchange rate but the Bangladesh Bank intervenes through open buying and selling of dollar to keep the Taka-Dollar exchange rate unchanged throughout the year. The policy-makers fear that exports will suffer due to re-value of Taka and inflation will increase due to decrease of its value. The price of dollar is not stable in global market but the Bangladesh Bank tries to keep the price of dollar stable in our money market through its intervention. It is not a solution in long term and not also good for the health of the economy.

The GCU may offset the impact of change in value of currency and help to bring equilibrium. Bangladesh can evaluate the system before adapting to global trade through the present system of open market-cum-control system.

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