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## **BOOK REVIEW**

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### **Currency Wars** **The Making of the Next Global Crisis**

James Rickards  
Penguin Books Ltd, 2011, London

During a war between two nations, one can imagine a nation printing currency of the rival illegally to damage her economy; however, Rickards makes an interesting point that, in the modern age, the rivals can manipulate the value of their own currencies in order to steal growth from the others. Germany, for example, did this during early decades of the last century and US, according to the author of this book, is doing the same tactics since early years of the current century against its main economic rival, i.e., China.

The author of the book, James Rickards, being an investment banker seems well aware of tactics used in the currency and derivative markets to influence the global economic outcomes. Since the dollar is playing a key role in the monetary system of the world, the analysis has been directed to it. As the role of dollar in the financial world have experienced a little setback after the introduction of euro, the rise of China and several other political events, the author is trying to predict the future scenario when the dollar will no longer be a dominant currency. Rickards foresees four possible outcomes: multiple reserve currencies, special drawing rights (SDR)<sup>1</sup>, gold standard and a chaos. The probability of occurring the last one, i.e., chaos is greater than the other three, the author concludes.

The book consists of three parts. The first part is about a mock financial war game. The second part tells about the history of currency wars and the last analyzes the outcomes of the third currency war that, according to the author, have started since 2010.

The book starts with a description of the Applied Physics Laboratory located halfway between Baltimore and Washington D.C. The author was invited there to

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<sup>1</sup> SDR is a currency controlled and issued by International Monetary Fund (IMF). The IMF keeps its books and records its assets and liabilities in SDR units. However, it is not used in the selling and purchase of commodities like other currencies. It, however, satisfy the traditional definition of money in many respects. It is used as one of the reserve currencies by the member countries of IMF. In case of trade deficits or surpluses, countries can settle trade balances with each other in SDR-denominated instruments.

participate in a financial war game. He, then, continues with an account of his participation in the war simulation. Acting on the advice of the author, the Russian team decides to no longer accept the dollar as a payment to the export of its oil and natural gas. Instead the Russian government, in the war game scenario, announced to issue a new gold-backed currency. The overall message of the first section is to show how unprepared the US policy makers are if dollar is rejected by the major economic powers as a trading currency of the world.

The second part of the book is a concise history of the exchange rate manipulation starting since the end of First World War to the present time. The author divides the history in three periods and names it currency war I, II and III.

The first currency war was started in 1921 and ended in 1936. I appreciate the author's analysis of the historical events particularly the policy conclusions he has made. Hyperinflation can be used as a policy lever, I learned from this book. The author cites the example of the Germany that gained from this policy lever. The Reichsbank (Germany's central bank until 1945) designed a massive devaluation of its own currency initially to achieve competitiveness and then to get out from onerous war reparations demanded by the Allied nations after the First World War.

The debasing resulting in hyperinflation made those Germans poor who kept their funds in stocks while those who owned hard assets such as land, plant and inventories remained protected. Although the author seems to be in favor of gold standard throughout the book, he explains that gold as a monetary system fails in the times of wars. Historically, nations in war were required to print money in bulk to finance their expenditures and the gold standard was, therefore, abandoned in those emergency situations.

At the end of currency war I, devaluing countries such as France and Germany gained a trade advantage over those who did not devalue. England that planned a return to the prewar gold standard and the United States suffered to some extent. "What followed after 1936 was not a continuation of currency war but the bloodied real war in history", the author concludes from the currency war I.

The U.S. policies and inflation were central to the currency war II during the period from 1967 to 1987. However, it was the devaluation of the sterling that triggered this war. This placed a crack in the Bretton Woods system and forced the United States to follow the same path as it was also experiencing from a combination of trade deficits and inflation. During this period, dollar got delinked from gold and was extensively devalued. This part is mostly about the economic

policies of the US government and their outcomes, i.e., low growth and high unemployment. A conclusion of this part is “Devaluation and currency wars never produce either the growth or the jobs that are promised, but they reliably produce inflation.” (p.96).

The author categorizes the period 2010 and afterwards as currency war III. The main players are United States, China, European Union, Japan, Switzerland and other economic powers of the world. The main front of this war is the struggle between China and the United States. Apart from creating employment opportunities and accelerating growth, the objective of this war is to remain politically dominant. This war includes not only official but also private players as business corporations act as an extension of state power in this globalized world. The Fed could use quantitative easing to influence the financial conditions in China. Quantitative easing by the Fed, which the author defines as just printing of money, meets the objectives of U.S government in China because of the Yuan-dollar peg.

According to the author, the risk associated with this new war is not just in terms of devaluation of currencies against each other but in terms of collapse of the monetary system itself – a loss of confidence in paper currencies and a massive flight to hard assets.

In the third part of the book, the author discusses four possible outcomes of this last currency war. The first is multiple reserve currencies after the collapse of the dollar as a dominant international currency. Multiple reserve currencies, however, can only work if there is an anchor or a reference point in the system. For more than half of the last century, gold has acted as an anchor and this role was later on taken by the dollar. However, if the confidence in the dollar itself experiences collapse, there would be no anchor left and so the system of multiple reserve currencies would not work as a feasible solution.

The second solution involves establishing SDR as an international currency. However, this faces the same problem associated with other paper currencies. One of them is that IMF has political leaning towards the United States which makes worldwide agreement on this currency difficult. Second, the collapse of the monetary system may happen before an agreement on SDR is reached.

As a third solution, the author presents a modified form of gold standard to be accepted as monetary system of the world. The author seems to be in favor of this system. However, he fears that economists consider gold standard as one of the reasons for the great depression and would, therefore, not agree on linking

currencies to gold once again. Also, in my view, gold might not work in the monetary system of the twenty-first century that have grown quite complex.

Finally, the author considers chaos as the most likely outcome. If the investors and traders find the dollar collapsing, the stress would be felt in all the markets. However, markets in commodities would experience rise. In the worst case scenario, a breakdown of civil order and eventual collapse of the physical infrastructure would happen. It is also possible that a process opposite to globalization get started. The links of world trade can collapse and the borders can get closed. Alternatively, the United States might declare a new gold-backed dollar that may restore the confidence gradually.

Although one can disagree with many propositions of the author, the book is worth reading as it puts forth new angles to common stories we read in the economic literature.

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