

World Bank chief surprises with gold proposal



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LONDON/WASHINGTON (Reuters) – The world's largest economies should consider gold as an indicator to help set foreign exchange rates, the head of the World Bank said on Monday in a proposal that threw open the acrimonious currency debate days before a summit of G20 nations.

Writing in the Financial Times, World Bank President Robert Zoellick called for a new monetary system to replace the floating rates adopted in 1971 known as Bretton Woods II.

In typical Zoellick style, the proposal before the G20 leaders' summit in Seoul is aimed at fueling a broader debate on currencies that goes beyond competitive devaluation wars.

The price of gold powered to an all-time high above \$1,400 an ounce on Monday, despite a bounce in the U.S. dollar, on concern about a weakening trend in the dollar, after the U.S. Federal Reserve last week resumed buying Treasury bonds to inflate its money supply.

The former U.S. trade representative, who served in several Republican administrations including Treasury, said the new system "is likely to need to involve the dollar, the euro, the yen, the pound and (a Chinese yuan) that moves toward internationalization and then an open capital account".

"The system should also consider employing gold as an international reference point of market expectations about inflation, deflation and future currency values," he added.

Zoellick did not spell out in detail how this system might work, but said it would help to rebuild the confidence of financial markets and the general public in the global monetary system after the financial crisis.

However, policymakers appeared cool to the idea, while many analysts said they doubted it would be implemented given practical difficulties.

European Central Bank President Jean-Claude Trichet said central bankers from around the world did not discuss returning to a gold standard at a meeting of the Bank for International Settlements in Switzerland on Monday.

"In my memory such an idea was mentioned a long time ago by Jim Baker when he was a

(U.S.) Secretary of Treasury in the 1980s. I have no particular comment," Trichet told a news conference.

A German government official, speaking on condition of anonymity, said Zoellick was correct in worrying that currency values were becoming too vulnerable to the whims of governments.

"The diagnosis that Zoellick is making is correct: that monetary policy is becoming overly politicized," the official said. "The system, as it is, is not functioning well."

But he added that it would not be practical to use modern monetary policy tools in a system that was "based on a commodity whose availability is dictated by natural conditions."

SUMMIT ACRIMONY?

That Fed's policy of quantitative easing, or EQ2, has fed acrimony among leading economies in the Group of 20 in the run-up to their summit in Seoul on Thursday and Friday.

China and Germany, major exporting nations, have both criticized the Fed's strategy -- effectively printing money -- which is weakening the dollar.

Investors are pumping dollars into emerging markets in search of higher yields, and the potentially destabilizing impact of this, along with big current account deficits and surpluses as well as China's reluctance to let the yuan appreciate faster, are set to dominate the G20 debate.

France, which takes over the G20 chair after this week's summit, says it plans to work on a new international monetary system to bring greater currency stability.

French officials said Zoellick's ideas mirrored initiatives that President Nicolas Sarkozy aimed to promote during France's 12 months in the G20 from next week.

Beijing's central bank chief has suggested an alternative monetary system based on using the International Monetary Fund's Special Drawing Rights, a notional unit of value based on a basket of major currencies, instead of the dollar as the sole global reserve currency.

Zoellick was a senior official in the U.S. Treasury at the time of the 1985 Plaza and 1987 Louvre Accords on rebalancing currencies among major industrialized nations. He noted that that phase of currency coordination helped launch the Uruguay Round of world trade liberalization negotiations.

While his opinion article in the Financial Times did not represent either U.S. or World Bank policy, it may reflect a greater openness in Washington than in the last two decades to some form of international currency cooperation.

"The dollar is losing its relevance especially with the emergence of Asia economies, so a more neutral benchmark may be required. Gold, amid all the recent uncertainty, is proving its worth," said ANZ's senior commodity analyst Mark Pervan.

Zoellick said a new monetary system would take time to develop and should be part of a package approach including possible changes in IMF rules to review capital as well as current account policies, and linking IMF monetary assessments to World Trade Organization obligations.

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