



**THE LEGO APPROACH TO  
INTERNATIONAL MONETARY REFORM**

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# I INTRODUCTION & OVERVIEW

WHY LEGO?

POST-1970 MONETARY TURBULENCE

COSTS OF MONETARY INSTABILITY

SOURCE OF INSTABILITY

“THE CASE FOR FLEXIBLE EXCHANGE RATES” IS BANKRUPT?

OBJECTIVE OF INTERNATIONAL MONETARY REFORM

TARGETS AND INSTRUMENTS

TARGET #1—STABILIZE REAL EXCHANGE RATE

TARGET #2—INSULATE ECONOMY FROM CARRY TRADE

PROCEDURAL —IMPLEMENTING MONETARY REFORM

## II POST-1970 MONETARY TURBULENCE

FOUR WAVES OF BANKING CRISES

BANKING AND CURRENCY CRISES OFTEN “TWINNED”

A BOOM PRECEDED EVERY CRISIS

INCREASE IN INVESTMENT INFLOWS LED TO BOOMS  
(EXCEPT JAPAN)

EACH BOOM MORPHED INTO A CRISIS WHEN  
INVESTMENT INFLOWS SLOWED

INVESTMENT INFLOWS TOO RAPID TO BE SUSTAINED

# III COSTS OF MONETARY INSTABILITY

BOOM AND BUST MACRO CYCLES

DISTORTIONS TO TRADE FROM CHANGES IN MARKET  
PRICES OF CURRENCIES

DISTORTIONS TO INDUSTRIAL STRUCTURE AS  
TRADABLE GOODS SECTOR SHRINKS

UNCERTAINTY ABOUT PROFIT RATE IN  
TRADABLE GOODS SECTOR DAMPENS  
INVESTMENT

# IV THE CASE FOR FLEXIBLE EXCHANGE RATES IS BANKRUPT

CLAIMS OF PROPONENTS

SCORECARD ON CLAIMS

ASSUMPTIONS OF PROPONENTS

SHOCKS EXCLUSIVELY IN GOODS

MARKET

INVESTOR DEMAND FOR FOREIGN

SECURITIES IS CONSTANT

CURRENCY MARKET IS “NOT INEFFICIENT”

PARTIAL EQUILIBRIUM VIEW NOT GENERAL

UNCERTAINTY—SYSTEMIC VS. TRANSACTIONAL

# V OBJECTIVE- INTERNATIONAL MONETARY REFORM

STABILIZE REAL PRICE OF A COUNTRY'S  
CURRENCY

MANAGE MARKET PRICE TO STABILIZE REAL  
PRICE

# VI TARGETS AND INSTRUMENTS

ILLUSTRATIVE EXAMPLE—BRITAIN 2006

TRILEMMA—WHEN CURRENCIES ARE  
ANCHORED TO PARITIES

TRILEMMA—WHEN CURRENCIES FLOAT

CRITIQUE—KEYNESIAN POLICY MIX

# VII TARGET #1 STABILIZE REAL PRICE OF CURRENCY

INSTRUMENT #1—ALPHA CENTRAL BANK SETS A NOMINAL CENTRAL RATE

ALPHA CENTRAL BANK SETS SUPPORT LIMITS—INTERVENES TO LIMIT CHANGES IN NOMINAL RATE

NOMINAL RATE AND SUPPORT LIMITS CHANGE AS PRICE LEVEL CHANGES

SUPPORT LIMITS CAN BE VARIED

# VIII TARGET #2 INSULATE ECONOMY FROM CARRY TRADE

THE MENU OF INSTRUMENTS

EXCHANGE CONTROLS, TAXES

HOLDING PERIOD REQUIREMENTS

CRITERIA FOR RANKING INSTRUMENTS

INSTRUMENT #2—VARIABLE CURRENCY

EXPOSURE HEDGING REQUIREMENT

FOR CARRY TRADE INVESTORS

# IX PROCEDURAL ISSUES—IMPLEMENTING MONETARY

EXAMPLE #1—“JOINING” THE GOLD STANDARD

EXAMPLE #2—INFLATION TARGETING

ALPHA CAN ADOPT TARGETS AND  
INSTRUMENTS ON ITS OWN, BETA MAY  
FOLLOW

# X CONCLUSION

FLOATING CURRENCY ARRANGEMENT

IS INHERENTLY DISFUNCTIONAL—

SOURCE OF MARKET FAILURE

NEED FOR AN ADDITIONAL INSTRUMENT

MONETARY REFORM—STABILIZE REAL

EXCHANGE RATE

**VII TARGET #1 STABILIZE THE REAL PRICE  
OF ALPHA CURRENCY**

**INSTRUMENT #1 ALPHA CENTRAL BANK  
SETS A CENTRAL RATE**