Beyond the Dollar Creditocracy: A Geopolitical Economy

By Radhika Desai and Prof Michael Hudson

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Preface

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"Beyond the Dollar Creditocracy: A Geopolitical Economy" is how American and Canadian economists Michael Hudson and Radhika Desai, respectively, titled their paper centred on the rise of the dollar to the financial Olympus and a potential de-dollarisation.

Weak growth in the global economy, low and negative interest rates, the risk of endless stagnation and rising inflation, and prospects for a prolonged recession are, unfortunately, part of the economic reality. Clearly, the globalisation-based financial supercapitalism model, of which the United States was a beneficiary for quite a long time, and which relied on endless lending and financialisation, which turned the commodity markets into financial ones, has run its course.

The global economy has reached the apex of an all-time lending boom, but the expansive growth of debt shows that most national economies are supported mainly by massive public and private borrowing. A major vulnerability has been identified in the global economic system that took years to build: halting the Fed's printing press, another crisis sweeping the United States, or even a slight increase in interest rates, will trigger a major economic crisis unseen since the Great Depression.

Many economists, analysts and researchers from different schools and areas strive to find a way out of the dead-end and to show prospects for new geoeconomic models. A book by Klaus Schwab, the founder of the Davos Forum, about the global reset received wide coverage in the media not so long ago[1]. It claims that the post-pandemic world will never be the same. It is certainly interesting to hear views on the future coming from the billionaire community, but there is also China and its position and a leftist train of thought.

The paper by Michael Hudson and Radhika Desai, who are anti-imperialist leftists, also explores the reasons for the financial world being the way it is, and how one can put an end to dollar hegemony and to create a multicurrency financial system before existing imbalances completely destroy everything.

But before you delve deep into the paper about the collapse of the dollar creditocracy, you need to take an objective look at the general picture of global finance.

So … The total amount of global money, including coins, banknotes and account balances, amounts to the equivalent of $37 trillion, with the US dollars per se accounting for about half of that amount, $19.2 trillion. If you add deposits to this amount, the global money supply in a broad sense will be equivalent to $98 trillion. And the entire value of global finance, which includes, in addition to money, investment vehicles (stocks, bonds or loans), derivatives and cryptocurrencies, exceeds $1.2 quadrillion.

Here are a few more figures … The global stock market capitalisation amounted to $96 trillion as of late 2020, and the US market accounted for 54 percent of that amount. Global debt (public and private) exceeded $280 trillion[2] as of early 2021, and the share of dollar denominated debt liabilities amounts to 57 percent of this total.

Radhika Desai and Michael Hudson's writings about dollar-denominated creditocracy are based on objective facts. The US dollar accounts for 85 percent of all settlements around the globe; it makes up 62 percent of the central banks' gold and foreign exchange reserves; more than half of global debt is denominated in US dollars and half of global cash also exists in the form of US dollars.

But were they too quick to jump to a conclusion about the collapse of the dollar creditocracy by analogy with the collapse of the British pound's hegemony after WWII? Can that much money, assets and liabilities just up and disappear, vanish, or be replaced by something else?

Clearly, global money will not go away overnight, although every year sees many publications about the collapse of the dollar or the United States losing its financial hegemony. Even a nuclear war cannot destroy that many assets. In the paper titled "Risk, resilience, and rebalancing in global value chains", released in August 2020[3], the McKinsey Global Institute estimates global economy losses from a hypothetical nuclear conflict at "only" $15 trillion. Losses from a pandemic caused by a dangerous virus are estimated at $30 trillion in the same paper, and losses from a "common" economic crisis at $10 trillion.

Of course, this does not mean that the dollar will dominate global finance forever. The Herbert Stein[4] law can already be used with regard to dollar dominance. It says: "If something cannot go on forever, it will stop." And this is happening not only because the United States has lost its hegemony, but also due to the enormous currency issue by the US Federal Reserve which, in the last few months alone, has slashed the value of the dollar against the basket of major currencies by 15 percent, as well as because of the excessive use of sanctions and the United States weaponising the existing dollar asymmetry in global finance and using it as a tool to exert pressure on its opponents and competitors.

Indeed, the distribution of cash and capital flows around the world is largely driven by what the main reserve currency, the US dollar, is doing and monetary cycles in the US. And it was the financialisation that went alongside the globalisation that made most markets dependent on fluctuations in the US Federal Reserve's monetary policy or the state of the US economy. The shortage or surplus of dollars flowing into the outside world leads to changes in the output of goods and services in the real economy of the rest of the world.

Decades of ultra-soft US Federal Reserve policy are the main reason behind the market bubbles and never-ending booms and busts in the global economy and the financial markets, amid a record-high level of global debt as a percentage of GDP (as of the time of writing, the debt has exceeded 355 percent of global GDP), low global economy growth rates and ever-shrinking investment.

Often, in order to compensate for the capital outflow caused by the Fed, or in order to redress their trade balance or balance of payments, China and a number of US trade partners responded by either devaluating their national currencies (currency wars), or using countermeasures to stimulate their economies and resorted to commodity dumping.

The dollar-centric system will inevitably transform into some kind of new financial system, possibly, a multicurrency and partly digital financial system. After all, the dominance of the British pound sterling came to an end at a certain point. Radhika Desai and Michael Hudson describe this fall of the pound in much detail in their paper, and also provide arguments as to why continental powers, including the Russian Empire, introduced a gold standard for their currencies to compete with the pound before WWI.

Does gold stand a chance of becoming money again? We will again find the answer in the numbers. The volume of gold held as a reserve by all central banks amounts to $11 trillion, and this is clearly not enough to provide money for the global economy with a GDP of $87 trillion, international trade and 7.7 billion people living on planet Earth.

Can the history of global money provide a clue about what turns global finance may take going forward? Perhaps, this is the main question I have for Radhika Desai and Michael Hudson's paper. The world has changed to become more digital and, unfortunately, unstable. The geopolitical picture is beginning to resemble the one that prevailed over 100 years ago before WWI. Some analysts believe that, in the third decade of the 21st century, a new era will begin in the economy, politics and lifestyle – the Age of Disorder – an era of clashing cultures and interests. Once over, it will give rise to a new world order as has happened more than once in the history of humankind.

Therefore, it makes sense to focus separately on how the US dollar, beginning with the Bretton Woods Conference of 1944, has become the main currency for trade settlements, savings and reserves. As noted in the study, the United States entered WWI as a nation of debtors and emerged from it as the largest creditor gaining access to European markets that were previously off-limits to the United States.

Following WWII, the United States became a superpower and gained not only political and economic superiority, but also the experience of how to profit from wars. US capital turned out to be the main beneficiary. Michael Hudson and Radhika Desai called it "creditocracy," although the American public then also felt the touch of economic prosperity and a noticeable increase in prosperity. At a time when the economies of the Soviet Union, Europe and Japan lay in ruins, the United States became the world's main manufacturer and exporter, and imperatively created the demand for dollars with its military-political influence, trade and … currency issue.

Dropping the gold standard and reformatting the Bretton Woods system in 1971 took place not only because of the collapse of the meeting of the Committee of Twenty on reforming the monetary system, as Radhika Desai and Michael Hudson say in their paper, but also due to the fact that because of rapid growth, international trade was simply running short of the level of gold backing needed in order to have the right amount of dollars for the global financial system to pay for goods and services and to keep the dollar monopoly intact in the process. The United States decided that international trade was more important than the gold backing of currencies. Indeed, it depreciated the dollar, but since then, everyone has been buying real goods on credit. And here we can agree that the creditocracy has been revivified.

After the Jamaica conference on January 8, 1976, gold became a common commodity, and the IMF issued a ban on payments in gold between the states. Special Drawing Rights (SDR) were introduced. At the same time, the "Triffi n Dilemma[5]" referred to by the authors of the study was resolved. The dilemma is about a disparity that arises if the national currency of only one country is used for international settlements between many countries: "in order to provide other countries' central banks with the amount of dollars necessary to form national foreign exchange reserves, the United States must constantly experience a balance-of-payments deficit, which undermines confidence in the dollar and reduces its value as a reserve asset; therefore, a balance-of-payments surplus is required to build confidence."

The Jamaican system refuted this paradox. Indeed, in order for the international settlements to take place as intensively as possible the United States must operate with a permanent balance-of-payments deficit. But this deficit is covered by the issue of credit money, and the internal US budget deficit and the growth of money supply do not contribute to inflation, since they correlate with the goods that are manufactured outside the United States. Radhika Desai and Michael Hudson are right when they say that financial engineering has outperformed industrial engineering in the United States.

Now is the time for a new level of financial engineering, but not in a specific country such as the United States or China, but all over the world. Financial bubbles will burst sooner or later. What's next? Many countries will need to find an answer on their own. Let's thank Radhika Desai and Michael Hudson for trying. But let's also keep the following circumstances in mind. The 2020 coronavirus crisis revealed the ineffectiveness of global governance institutions, which failed to help states coordinate their efforts to combat the spread of the virus, and which are very limited in terms of the choice of tools for lifting the global economy out of recession. Dealing with the crisis aftereffects often leads only to the issuance of more dollars, euros, yen, yuan, etc.

The current geopolitical changes are laden with a great deal of uncertainty. Competition is exacerbating and regionalisation is accelerating. Digital technologies in finance and e-commerce have become the prerequisites for survival of so many businesses. The constraints created by the existing global financial infrastructure will stimulate the creation of multiple alternative information and financial networks. The finance technology and the banking sector will change, and money supply will take on outlines of its own. Given these circumstances, the value of innovation is increasing, but the cost of mistakes has also become high. All global financial system transformation projects must be tested for the possibility of cooperation between countries and for the possibility of interacting with digital networks and they need to be evaluated based on long-term viability in the context of an evolving economic model.

The countries that create their own rules and technologies and consistently uphold their interests, including in the financial sphere, keeping in mind the ability of digital currencies to bypass old dollar-based international payment systems overseen by the US Treasury in cross-border settlements, will have the edge in the transformation that is currently underway.

Of course, in the early stages, many countries will face pushback from the United States, as this paper mentions. But it will be difficult to oppose objective processes, and will be almost impossible as technology improves; therefore, the multicurrency global financial system will sooner or later become a reality and the ideas of digital currencies will be supported by many countries.

Introduction

As President Biden continues his predecessor's New Cold War on China, it is clear that the pandemic has vastly accelerated the on-gong shift in the international balance of power, away from the US and towards China. For former US Treasury Secretary, Lawrence Summers, it was likely a 'hinge of history': '[i]f the 21st century turns out to be an Asian century as the 20th was an American one, the pandemic may well be remembered as the turning point'. It would erase 9/11 and 2008 from memory and rank alongside 'the 1914 assassination of the Archduke, the 1929 stock market crash, or the 1938 Munich Conference' (Summers 2020).

However, Professor Summers misses the point. The twentieth century, from our point of view, was actually more an attempted American Century than an accomplished one (Desai 2013) and the shift away from it is looking more certain and decisive than the 'ifs' in his assessment let on. The pandemic is less a hinge than an acceleration of the decline of US power based on financialised neoliberal capitalism (Desai 2020a). The structure of world domination that the US had sought to foist on the world in recent decades is breaking down. The US never succeeded; the structure was too unstable and volatile to work. Therefore, one cannot blame the pandemic for reversing even its limited successes. The reversal is rooted in a geopolitical economic earthquake whose rumblings date back decades. They have loosened more and more countries from the contradictory and crisis-prone structures of US domination.

The core of all international power structures of the 'capitalist mode of foreign relations' (Van der Pijl 2014) lies in the international monetary system – what James Steuart called 'the money of the world' in 1767, referring to the means by which countries settle their trade or financial imbalances among one another. The domination the US sought to exert was no different. At its heart lay the dollar-denominated international financial system that we call the Dollar Creditocracy. It has undergirded the dollar's world role since the early 1970s and its unravelling leads the denouement of US power.

The financial commentariat is already expressing foreboding of the dollar's coming doom. 'The decline of the U.S. dollar could happen at "warp speed"', warns Market Watch, while Reuters reports more sedately on how 'King dollar's decline ripples across the globe'. While set-tos between dollar boosters and gloomsters have long been a feature of the crises that have regularly punctuated the dollar system, what was remarkable is how many are changing sides. Benjamin Cohen (2020) warned of the end of the dollar's 'exorbitant privilege' and Stephen Roach (2020) warned of a 35 percent drop in the dollar index over the coming two to three years. Although some boosters such as Barry Eichengreen (2020) stuck to their guns, they were clearly low on ammunition, unable to fi nd solace in anything other than lack of alternatives.

Such commentators sense that doom lies ahead. However, they are far from explaining why. Cohen blamed it on Trump's disastrous pandemic management, added to his tendency to weaponise the dollar, and Roach blames it on increased US borrowing. However, these explanations, like most commentary on the dollar's world role, is tangled in that combination of wishful thinking and wager that one of us identified as the international financial intermediation hypothesis (IFIH) (Hudson 1972/2003). It emerged from the difficulties that ended the dollar's link to gold in 1971 to conjure up a new basis for the dollar's world role. By making the so-very-clever argument that the US was no ordinary indebted country but the world's banker and that its deficits were loans to the world, a public service the world should accept gratefully by lifting capital controls and deregulating finance, this interpretation attempts to normalise the transformation of the US economy from super creditor to super debtor. However, it was never more than a barely adequate fig-leaf.

Our purpose in this article is to cut through this interpretation. Despite its faults, it dominates our understanding of the dollar system. In its place we reveal one that is theoretically sound and accords with the historical record, a geopolitical economy (Desai 2013) of the international monetary system of modern capitalism. We begin with a theoretical outline of how money operates under capitalism. We then consider how capitalism needs world money and, at the same time, makes its stable functioning difficult. We then go on to trace the fundamental instability of the modern international monetary systems based on national currencies of dominant countries, from the gold standard to the current volatile and predatory dollar-centred system, and their close connection to short-term and speculative as opposed to long-term and productive finance. We conclude by discussing of the key instabilities of the dollar system and the paths that various countries and international organizations are already taking to move beyond its destructive logics.

Read the full report here.

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