

Nothing in Sight to Replace the US Dollar as an International Reserve Currency

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Region: [USA](#)

Theme: [Global Economy](#)

"The empire of the dollar is crashing." Hugo Chavez, Venezuelan President

"The U.S. dollar is a worthless piece of paper." Mahmoud Ahmadinejad, Iranian President

[The U.S. dollar is] "losing its status as the world currency." Xu Jian, vice director, People's Bank of China,

"It is the policy of the United States and it will remain the policy of the United States to remain committed to a strong dollar." Timothy Geithner, U.S. Treasury Secretary, (July 15, 2009)

[The dollar will remain the world's dominant currency for] "many years to come." He Yafei, China's vice foreign minister, (July 5, 2009)

Presently, there is a vacuum in international affairs coming from the decline in the moral and economic stature of the United States. It is a vacuum because no other country or organization has the credibility, legitimacy and capability to fill the gap. This is particularly true in monetary and financial affairs. By default, the U.S. dollar is de facto the main supranational key currency used to finance international trade and investment.

Many countries deplore this quasi monopoly of the dollar, the more so since the financial crisis that originated in the U. S. has spread around the world, and it has profoundly damaged the reputation of the United States and severely undermined the confidence that this country inspired in the past. Add to that the illegal war of aggression that the Bush-Cheney launched against Iraq, a country that had not attacked the United States, and the lack of financial confidence in the USA is reinforced by a lack of political confidence.

The table is therefore set for revisiting the international monetary arrangements that were created in the aftermath of World War II. What were they?

In June 1944, during a monetary conference held in Bretton Woods, New Hampshire, an attempt was made to create a new world currency, above and beyond the national currencies of particular countries. Let's keep in mind that many decades before, the British pound had been used as the main international currency. A first proposal for reform came from British economist John Maynard Keynes, who advanced the idea of creating a supranational currency, the *bancor*, to which other currencies would have been pegged and in which countries would have held their foreign exchange reserves. An alternative plan was

proposed by U.S. Treasury economist Harry D. White, in view of establishing a “Gold Exchange Standard” whose main characteristics was to use the U.S. dollar as the main key currency, the only currency then that was fully convertible and which had an official value in gold, initially at a rate of one dollar for 1/35 ounce of gold, and later, at a rate of 1/38 ounce of gold. As we all know, this was the plan that was adopted. Nevertheless, Keynes’ idea was partially adopted when the International Monetary Fund (IMF) created “Special Drawing Rights” (SDRs) in 1969, to supplement the member countries’ stocks of international reserves.

On August 15 1971, however, the U.S. Government unilaterally ended its obligations to convert U.S. dollars into gold. A few years later, in the aftermath of the first oil crisis, the rates of exchange of currencies of most of the industrial world were allowed to fluctuate with the state of their balances of payments, thus reducing considerably the need to hold foreign exchange reserves, most of which were still denominated in U.S. dollars. —This is the system that has prevailed until now, that is to say a flexible exchange rate system with the U.S. dollar as the main key currency.

It seems nowadays that most everybody who holds dollar-denominated assets is calling for a new international monetary system. The largest creditors, the Chinese, have initiated the debate, because they have the most to lose from the collapse of the U.S. dollar. Even the Catholic Pope has thrown in his piece of advice.

What are the chances that there could be agreement on a new supranational key currency? —Close to none. Essentially, this is because there is no viable alternative to the U.S. dollar as an international currency.

It is true that the United States, as a sovereign country, has abused and is still abusing its privileged position derived from the fact that its national currency is being used as the world key currency. So much so that there is presently an oversupply of U.S. dollars around the world. Over the years, the USA has built up huge external debts without having to suffer the full economic consequences of its profligacy. Moreover, it has used its seigniorage gains to deploy troops and military equipment around the world, a move that has created much resentment.

Politically, thus, but also financially, the rest of the world finds it increasing difficult to have to rely mainly on the U.S. dollar to finance international trade and international capital movements. It is therefore understandable that many countries would like to free the world from the obligation to use the U.S. dollar.

The most natural complement or substitute to the U.S. dollar as an international key currency would be the euro. After all, this is a currency backed by fourteen strong European countries; a currency that is fully convertible into other currencies and a currency that is supported by large money and capital markets.

The euro’s major weakness comes from its political base. If the entire 27-country strong European Union (EU) were backing the euro, its long-term international standing would be considerably enhanced. With only half of the E.U. countries backing it, the euro zone is vulnerable in the future to a possible dissolution under the pressures of economic hardships. This is more so since the statutes of the European Central Bank are unduly rigid, not only freezing exchange rates between member states, which is OK, but also de facto freezing

their fiscal policies, while the central bank itself has the goal of fighting inflation as its only objective. It seems that the objective of supporting economic growth was left out of its statutes, with the consequence that it may be unable to ride successfully future serious economic disturbances. For example, how long do you think countries like Spain are going to tolerate 17.9 percent levels of unemployment? —Nevertheless, already one quarter of the world's official reserves are in euros, as compare to a bit less than two-thirds in U.S. dollars. Baring any mishap, the dollar and the euro should share a more equal proportion of international finance in the future.

It is also said that the Chinese renminbi (its main unit is the yuan) could be called to play the role of a global currency. Since 2005, China has adopted a managed floated exchange rate system for its currency, allowing the yuan to slowly appreciate vis-à-vis other currencies, as a partial reflection of its large foreign trade surpluses. It is pointed out that by 2020, China intends to designate the city of Shanghai as an international financial center, and that would mean that the renminbi could become fully convertible into other currencies. Already, some transactions between Hong Kong and Macau, and Mainland China, are being settled in renminbis.

Realistically, however, it is most unlikely that a Chinese currency could play a large international role, at least not for decades to come. Indeed, even though the Chinese government has some \$2 trillion in official foreign reserves, China, itself as a country, has a very limited moral international stance. It is still a totalitarian, authoritarian and repressive state regime that does not recognize basic human rights, such as freedom of expression and freedom of religion, and which crushes its linguistic and religious “minority nationalities”. It is a country that imposes the death penalty, even for economic or political crimes. —This is not an example to the world. Only a fundamental political revolution in China could raise this country to a world political and monetary status. This is most unlikely to happen in the foreseeable future and, therefore, no Chinese currency is likely to play a central role in financing international trade and investment.

It is one thing to wish to replace an international key currency, it is quite another to implement such a wish. It's not that a series of bad policies has weakened the U.S. economy and the U.S. dollar, possibly for many years to come. But the requirements for a national or international currency to be used as an investment vehicle are such that there is currently no credible successor to the U.S. dollar as a key currency. There are three fundamental characteristics that a reserve currency must have: it must inspire confidence, it must be fully convertible into other currencies, and it must have a high degree of liquidity. With the possible exception of the euro, no other currency meets these criteria, although creditor countries will likely increase the share of gold in their official reserves, pushing the price of gold way up in the coming years.

Therefore, for better or for worse, the world economy needs the U.S. dollar and will keep using the U.S. dollar for the foreseeable future, before a new international monetary system can be designed many years down the road. —Therefore, you may ask where do I think the U.S. dollar is heading? With \$2 trillion fiscal deficits under Treasury Secretary Geithner' watch, a zero interest rate (negative real interest rate) and an open bar printing monetary policy by the Bernanke Fed, there is currently an oversupply of U.S. dollars. This should herald a period of continued weakness for the U.S. dollar, possibly for a year or two. Then, the U.S. dollar should reach an important and secular climax low vis-a-vis the other fiat currencies, but not vis-a-vis gold whose future looks brighter by the day.

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