The Dollar's Fate

Paul Kennedy (WORLD VIEW)

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There is a most interesting debate going on at present in the academic community about the longer-term fate of the US dollar as the supreme reserve currency for foreign-exchange transactions and, more importantly, for the currency holdings of national governments, global companies and the producers of oil, gas and other raw materials.

This attracted journalistic attention at the time of the G20 meeting in London this past April, when the International Monetary Fund received a fresh allocation of $250 billion in special drawing rights (SDRs).

Two months later, the issue came up again at Yekaterinburg, Russia, where the famous meeting of the government heads of the BRICs—Brazil, Russia, India and China—suggested to commentators that a transnational coalition of rising states might pull Uncle Sam down to size, in part by countries shifting their currency holdings from the dollar into these IMF units of account.

A generous interpretation of all of this international confabulation is that it actually is rather better for the world to have its monetary exchanges based upon some international "spread" of currencies rather than upon a single one that, if it toppled due to domestic mismanagement, could bring ruin to many innocent players, especially perhaps poorer states dependent on the US dollar. Had not the great economist John Maynard Keynes proposed this with the creation of the bancor in 1944, to head off a dollar-denominated world that would in the end meet its fate of carrying too much on its shoulders?

This would have been good for the international community and, actually, good for America. The nastier interpretation of this move toward ending the dollar's pre-eminence is, be there no doubt, an anti-American one. It seems to be in the nature of things that the leading Power in world affairs is always resented by countries further down the totem pole, even when that hegemon is fairly successful at distributing what economists term "public goods."

If, therefore, the rising economies of Brazil, Russia, India and China decide to have their own get-together, it is scarcely surprising that they would discuss the international trading and financial system, and how to become less dependent on America's capacity (through sub-prime mortgages, lousy banks, currency dominance) to wreak damage upon it.

To some, a weakened dollar might also be a blow to US arrogance, and a reminder that even "top dogs" can be tripped up. Removing the dollar's "unfair" advantage, as the primary reserve currency has always seemed agreeable to French intellectuals and, the record shows, to French presidents from De Gaulle to Sarkozy. So why not, then, push for a more equitable "basket of currencies" to grease the world's commercial exchanges or, as a variant of that, try to arrange trade through the medium of the IMF's special drawing rights? It seems reasonable—and thus defensible—and it would also bring down the Americans a peg or two.

It turns out, however, that there all sorts of reasons why those SDRs cannot at present function as a common currency, that is, as something you would price a Toyota car in, or as a wad of bills you could withdraw from a cash machine. Their function is inter-governmental by nature and not at all like, say, Barclay's foreign-currency departments. This was well explained recently by the financial writer Swaminathan S. Anklesaria Aiyar of The Cato Institute, in Washington ("An International Monetary Fund Currency to Rival the Dollar?," July 2009, for readers who want more details). It should be noted that Aiyar

Aiyar cold-bloodedly argues that the dollar's relative fall will much more likely come as a result of the continued growth of China's GDP and the future arrival of the yuan as a fully convertible currency—and not as a recourse by the governments of the world to some artificial IMF instrument like the special drawing rights. With the yuan joining the euro, the yen and the dollar as the four biggest foreign currencies by far, there will be even less pressure and logic for substitution of the traditional means of money exchange.

Just a short time before reading Aiyar, my eye was caught by a rather extraordinary article called "The World Supremacy of the Dollar at the Rendering (1917-2008)" by the superb Italian scholar Antonio Mosconi of the Einstein Centre for International Studies (CESI). The title itself is so intriguingly biblical—as in "rendering unto" one's God, or to Caesar—that I immediately wanted to know what it said.

For those with less time on their hands than university professors, it said this: The US dollar has lived two lives, the first as the currency of a powerful creditor country from the 1920s to the 1960s, the second as the currency of an "empire of debt" from the 1970s until today, with much more international indebtedness to come, simply from the wretched fire sale of Treasury bonds every week.

It is impossible to summarise in a few sentences Mosconi's devastating and elegant description of the US government's exploitation of its domestic paper-printing capacity upon the international fiscal scene, but his general conclusion is blunt: "This crisis is not like the others, but it is the last convulsion of the international role of the dollar." At some time in the future, much of the world will take steps to avoid having its fate rest upon the autistic decisions of the U.S. Treasury and the Federal Reserve Bank. And then will come the rendering . . .

Well, we shall see. Given the nervousness of world markets at present, it is as possible that we could see an improvement in the dollar's exchange value as watch a sudden slump. Overall, though, these academic papers make some basic sense. We live in a world right now where one single country, possessing only about 5 per cent of the earth's population, has roughly 20 per cent of its GDP, spends almost 50 per cent of its total defense expenditures, and freely prints bills that account for 65-70 per cent of global foreign-currency reserves. If one believes in the economists' theory of "convergence"—that is, the coming closer together of the product and income of companies, regions and countries—then the conclusion is clear: As China, India, South Korea, Brazil, Mexico and Indonesia all "catch up," the American share of things will relatively shrink, even if the inhabitants of Virginia and Vermont are absolutely richer by the year 2050. Sooner or later—and if you think about it, this debate really is about "sooner" or "later," not about "if"—we are going to witness another major shift in the global balances of power.

Even in the shorter term, and especially if I were a money manager interested in protecting my clients' future interests, I guess I would be looking a little more keenly at the current distribution of my portfolios, just to ensure that when I had to come to "render my accounts," I would not look awfully out of date. And, as an international author, I am happy to take my fees and royalties in many currencies, just to be on the safe side.

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