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The US Dollar is Here to Stay

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With the Bretton Woods system, the US Dollar became a symbol for stability and prosperity. However, since the global currency system collapsed in the early seventies, the dominance of the dollar has been questioned more or less continuously. With the global economic crisis of 2008, dollar pessimists were on the upswing once more, and in 2010 Maximilian Mayer and Jost Wübbeke that "in sketches, a new currency geography is already recognizable".

Yet until now, the dollar has remained the only globally dominant currency, profiting from crises both recent and historical, as a relatively "safe haven" for investors. Common examples for the dollar‘s leading position include its role in the trade of key commodities such as oil, metal, and agricultural products, all of which continue to be denominated in dollars. Today there are more than $829 billion dollars in circulation, the majority outside of the US (Fed 2008). According to The Economist (2011), 66 countries worldwide use the dollar as a legal tender, peg their currencies to it or run their exchange rate against it. All in all, the dollar remains the number one in all international currency functions.

But will the dollar be able to defend its leading position in the foreseeable future? It is true that the dollar is confronted with many challenges, both external and internal. Dollar pessimists like Benjamin Cohen, David Calleo and Jonathan Kirshner (Helleiner & Kirshner 2009, p. 221) put forward strong arguments for their outlook regarding the future of the world's most influential currencies: On the one hand, they point to the fact that during the past decade, two currencies, namely the renminbi and the euro, have been gaining importance as international (but still regional) currencies and are now competing against the dollar. On the other hand they worriedly observe the US debt problem, which at the moment seems to be hardly solvable.

Will the dollar be capable to stand up against its competitors? Will it be dominant enough to impact all regions or are different regional currency hierarchies more likely, as predicted by Mayer and Wübbeke? In this paper, we argue that the dollar's foreseeable future is not at stake. Over the last decades, the dollar has asserted its global dominance and its essential role in international trade. While other currencies, most prominently the euro and the renminbi, might one day be able to challenge the dollar, currently they lack the ability to do so. Moreover, there is hardly any reason to question the US' ability to adapt successfully to the ever changing environment of a globalized economy. But not only that the US still shows intrinsic economic strength – the dollar is also supported by the global currency system, which has despite all crises been labeled tried and proven.

1. A Strength from Within

The influential British magazine "The Economist" – a strong believer in the dollar – has recently named the US economy the "Comeback Kid" (The Economist 2012). Also in continental Europe it is claimed for example by Andreas Dombret, board member of Deutsche Bundesbank, that the dollar has impressively demonstrated its importance as a "safe haven" for investors and asserted its global dominance (Helleiner & Kirschner 2009, p. 24). Those optimistic assumptions are based on the fact that the US economy is (still) the most powerful of the world and they reflect on the global standing of the dollar as an internationally used reserve currency.

According to Cohen's conceptualization of the roles of international money, there are three functions of a key currency, categorized as "store of value", "medium of exchange" and "unit of account", each of which exists on a private and a public level, making for up to six distinct fields of enquiry (Cohen 2011, p. 9). The dollar successfully fulfills all these six functions. 60% of currency reserves stocked by central banks worldwide are held in dollar (Eichengreen 2011, p. 2). Moreover, it is used as official currency in seven countries, most of them in Latin America, in a process known as "Dollarization" (Goldberg 2010, p. 3). About fifty countries currently peg their currencies to the dollar, 86% of global trade is denominated in dollar, and the prices for major commodities on the world market are expressed in dollar. Moreover, the dollar is also used in 85% of all foreign exchange transactions worldwide (Eichengreen 2011, p. 1).

	Medium of Exchange	Unit of Account	Store of Value
Private	Foreign exchange trading, settlement	Trade invoicing	Investment
Official	Intervention	Anchor	Reserve

(Cohen 2011, p. 9.)

How was it possible for one currency to become so dominant? Historically, the dollar has gained international importance ever since the founding of the Federal Reserve in 1913/14, culminating with the implementation of the Bretton Woods system in 1944. Even today, forty years after the end of Bretton Woods, the dollar is still synonymous with prosperity, being present in the occidental culture as for example in Andy Warhol's work "200 one dollar bills", the infamous "Scrooge McDuck", as well as in Hollywood films and music videos as a sign for wealth. No other currency in the world has acquired such extensive cultural appreciation as the dollar.

One of the decisive factors for the dollar‘s hegemony is the economic power of the United States. According to criteria set up by the IMF (IMF Statistics Department COFER Database 2012), a country must have a high GDP and maintain tight trade relations to maintain a trusted lead currency. Countries with such a profile also tend to have very well developed and unitary financial markets, which allow investment in the markets and acquisition of savings and international reserves at a low cost, for diverse products as well as relatively risk-free. These facts, combined with long-term economic stability create trust in a currency. Having been once established in the position of the world's only key currency its status cannot be overturned quickly because it perpetuates itself systemically (Cohen

The US economy also excels in measuring up to the IMF model. The GDP of the US is the highest in the world at $15.596 trillion dollar (Federal Reserve Bank of St. Louis 2012). One of the most important sources of revenue for an economically powerful country such as the US is foreign trade. Revenue from exporting goods and services amounts to $1.842 trillion, while imports are at $2.267 trillion (Federal Reserve Bank of St. Louis 2012). About 30% of its exports go to America's partners in NAFTA, Canada and Mexico, with China coming in third place with about 7%. Chief exports are capital goods at 49% and industrial supplies at 27%. On the other hand, China has become the most important source of imports for the USA, which gets 19.5% of its total imports from there, with industrial supplies and consumer goods making up for about two thirds of the goods imported from China (CIA Factbook 2012). A high GDP, tight trade relations, highly developed and unified financial markets, while present in other developed countries to differing degrees, are what keeps the American economy going and the dollar strong.

While today's hegemony of the dollar appears to be omnipresent measured at the different criterions presented, the aforementioned Mayer and Wübbeke still consider the advent of a multipolar monetary system to be imminent, opening up the discussion of whether the euro or the renminbi might be able to share the lead with the dollar.

2. Competitors on the Rise?

Two currencies discussed by financial experts as possible competitors against the dollar, the euro and the renminbi, are the two strongest regional currencies in the world today. But will one of them ever ascend from their current regional hegemony to become a global currency?

Considering the euro, one has to be very skeptical as to where it is going. When Mayer and Wübbeke wrote their paper focusing on the decline of the dollar and the subsequent rise of the euro to prominence, the euro was still considered a relatively stable currency, coming out of the beginning of the financial crisis in 2008 seemingly unscathed. The same cannot be said today. Even though the euro is not in free fall, some argue and have always argued that the euro should be recognized as an experiment that failed (Feldstein 1997, p. 41). Its value relative to other currencies has been declining steadily for the last three years. The first part of this weakness relative to the dollar is how the common currency reacted to the financial crisis reaching Europe in October 2008. The drop in the exchange rate from about $1.60 to €1 in mid-July 2008 to $1.24 to €1 in late October 2008 speaks to it. This crisis appeared to be overcome by 2010, with Mayer and Wübbeke predicting – correctly, given their frame of research – an increased investment in the euro with China switching to the euro as an alternative reserve currency, opting out of the dollar. This has, however, not happened. In fact, the recent economic crisis in the EU has led to a reversal of their predictions, with more and more countries actively selling their euro reserves, according to the UN Conference on Trade and Development, fleeing a currency they consider to be doomed, further devaluating the euro.

Is the euro even destined to remain a regional currency, with whatever aspirations it might have had to be a global player thwarted? It was not economic advancement for its own sake that gave birth to the common currency, but the hope that a common currency would lead to a stronger regional integration, further expanding the sphere of influence of the European Union (Feldstein 1997, pp. 23-24). It seems that the euro has failed to do so. One would be inclined to agree with Giovanni Pittaluga (2011, p. 104), that the euro will remain more of a regional currency, given the Eurozone's lack of control over their currency. This might seem paradoxical at first, given that there is an instance within the EU known as the Eurogroup focusing on safeguarding the stability of the euro. The inefficiency of that group becomes obvious, however, by taking a closer look at what their capabilities actually are. They describe themselves as an "informal group" on their website, giving little credence to their ability to actually enforce certain policies pertaining to the euro. This is what Pittaluga means when he considers the EU to lack "adequate political-military leadership" (2011, p. 104).

The lack of enforceability in the EU can be seen clearest in the current economic crisis. Faced with the possibility of a dissolution of the Eurozone, European institutions like the ECB have done all they could to prevent a possible disaster, failing, however. It is understandable that this has happened. Where the US is a federal state, the EU has a much looser framework, with common interests habitually trumped by the individual interests of its respective member states. It is an institutional problem rather than a simple lack of ability that keeps the European institutions from solving the crisis, leading to individual countries vying for different ways out of a common crisis. Given the relative weakness of European institutionalism which is already seen as exceeding its mandate by some (Watts 2012), the euro as a relative newcomer and after only ten years of existence already a candidate for systemic redesign cannot hope to be considered a challenger for a leading role in the field of global currencies.

Another currency that is being discussed as possibly emerging to challenge the dollar is the Chinese renminbi. Introduced in 1948 to counteract the hyperinflation in China, it has developed into a currency with global relevance, first being exposed to international trade in 2009 and continuing to gain in importance. Indeed, when looking at China's economic power, being geared towards export mostly, the benefits of implementing a monetary policy of renminbi internationalization are evident. A large export industry implies that the currency is being used as a reserve in other countries, fulfilling one of the classic functions of a key currency, improving China's position in international politics (Chey 2011, pp. 54-56).

With the advent of the 2007-2009 economic crisis, the Chinese government implemented plans to internationalize the renminbi, taking steps for the currency to become a global player, asserting its independence from the dollar. China's economic power will fall flat if the renminbi is not allowed to be freely traded outside of the country. However, this undervaluation and limiting of the currency's power, that is actually backed up by a strong export-oriented economy has been the Chinese way of doing business for the last decades. These policies still hinder the development of the currency today. While China is opening up its markets, lowering entry requirements and simplifying application processes for foreign investors (Hong 2012), it still has a long way to go. Even renminbi enthusiasts argue that it will take the currency another decade to become a leading reserve currency (Prasad & Ye 2012, p. 2), while the Chinese government itself and economists alike believe that the renminbi will be considered by the IMF to be included in the Special Drawing Rights basket by 2015 (Yassin 2011).

It is in fact the central government that will be able to decide on whether the renminbi will become a global player, mostly by deregulating the currency. Agreements with other emerging countries, such as Brazil, have shown a willingness to deregulate. Moreover, in June 2012, China and Japan have started trading in their respective currencies directly, with the goal to limit the dollar's presence in the region (Xinhua 2012). But is a total opening of its financial sector in the foreseeable future even in the China's best interest? For China, exports are crucial to the economy, accounting for more than a quarter of economic activity. An opening of the financial sector, though, would lead to the renminbi becoming a global reserve currency. Gains from being such a reserve currency, however, are actually almost negligible, with the economic downside that if Chinese products would become pricier, export would decline. Since the export surplus can be considered as the driving force behind the economic and social changes currently taking place in China, if this surplus was to diminish, China's transition from an emerging economy to a global player would be disturbed (Xiao 2010). The development from an export-oriented strategy to a more sustainable economy based on domestic demand can only work gradually.

While the renminbi is currently rising towards the level of a regional currency, which can be interpreted as a possible intermediary position for a leading global currency, the central government has at its disposal another possibility to bring about a rapid change in the global economy. China currently holds the world's largest amount of dollar-denominated reserves by far. Flooding the market with dollars to devaluate a rival currency appears to be a viable option. It is highly unlikely, however, that such a measure will be implemented, as China would thereby suffer a devaluation of their own assets, estimated at about 20% of China's GDP in renminbi (Ferguson & Schularick 2011).

The Chinese economy actually profits more from a regulated renminbi, kept at an artificially low level. The trade surplus is used to further domestic as well as international goals. This, combined with the huge dollar reserves, constitutes an impressive power of the Chinese state. As long as this power is greater than the power gained by a renminbi appreciation, the renminbi will be kept at a level that garners the most profit for China, which is, in its current developing state, to safeguard exports. An artificially limited renminbi is in China's best interest at the time. And as long as this situation persists, the renminbi cannot challenge the dollar's global dominance.

While it can thusly be shown that other currencies like the euro or the renminbi are not able to challenge the dominance of the dollar, there are other challenges to it, both external as well as internal, with the US debt crisis one of the most prevalent problems in recent times.

3. US Debts - A Point of No Return?

At the verge of the so called "Pacific Century", the US presidential debate does not remain untouched by the exterior attacks on the dollar. However, more important for the upcoming presidential elections are the dollar's interior challenges. On his web site, presidential candidate Mitt Romney warns against a possible collapse of the US economy due to the high national debt burden: "A point of no return may well be approaching – a decade of huge deficits could drive our principal payments and interest rates beyond our reach while starving the economy of the capital it needs to grow" (Romney 2012).

Concerns as this have been articulated more and more frequently since the beginning of the financial crisis of 2007-2009, as the total budget deficit of the US has grown up to 15 trillion dollar. The choice of means in order to fight the crisis are as usual: tax increase, printing money, and/or cuts to public spending. Today, these solutions appear to be politically rather not enforceable. The confidence in Washington's political efficiency has weakened. In summer 2011, the political blockade of the Republicans on the passage of the national budget by a hair led to the scandalous insolvency of the biggest economy of the world. With increasing polarization along party lines in congress, even after the general election in November, gridlock is most likely here to stay for at least the next two years. Printing new money, yet, has often seemed the best alterative, because the US profits from the seigniorage effect and the fueled inflation "reduces" the value of the national debt. Contrariwise, it increases the amount of dollars, making the US the "debtor empire" (Ferguson 2004, p. 279).

Historically, the US got into this fiscal overstretch (Ferguson 2004, p. 262) with open eyes. Throughout the Cold War, the American government got more and more indebted. Budget deficits have become normal practice in Washington. Within the last three decades, only president Clinton managed to generate a national budget surplus in his second term. Today, according to the CIA, the national debt is at 69.4% of GDP (CIA Factbook 2012), which compared to other Western countries is still moderate. One of the central problems is the enormous US foreign trade deficit which goes hand in hand with a general economic slowdown, which has yet to be overturned into a unambiguous and steady upswing. Meanwhile, the US policy makers are facing a dilemma. On the one hand, stimulating domestic consumption on a level exceeding all measures taken by the Fed so far causes the foreign trade deficit as well as the national debt to rise even further. On the other hand, a tax increase or a savings policy as implemented in Europe is condemned as potentially leading to recession.

But is that really the gist of the matter? The US can still buy money on an international level, with financiers still willing to invest at relatively low interest rates. Pessimists see a tremendous peril on what has been called the “debt horizon”, a peculiar combination of a crisis-induced decline of the general fertility rate (CDC 2012, p. 6), badly educated adolescents, a weak infrastructure and a costly health system, which will need to cover 77 million baby boomers in the next years (Ferguson 2004, p. 270). These are reasons why confidence in the dollar has been shaken in recent years. Following this logic, the day that the US government will be unable to pay the higher interest rates demanded by its creditors is drawing near, with the downgrading to an AA+ level in August 2011 seen as a definite signal. However, these worries still remain highly speculative. In a climate of crisis, the dollar is still seen as relatively stable and trustworthy. Even the bankruptcy of Lehman Brothers in 2008 did not discourage investors from buying dollars.

In spite of the pessimistic argument and the perception of the political discourse, other aspects might point to a possible way out of the US debt crisis. The US will most likely try to stimulate their economy with different measures in order to create economic growth and balance their budget. Furthermore, given the current process of a restructuring of center-periphery flows, it is possible that the production sector will once again become important in western countries. With Asian salaries on the rise, making production under previous conditions unfeasible, as well as the widespread immigration of trained workers into the US, not only could it become economically feasible once more to focus on domestic products, the problem of the trained workforce needed would also be solved. Lastly, the US will profit from advances in resource procurement, seeing as they possess a great amount of shale gas and thus a great amount of cheap energy reserves (Grundlehner 2012). What will bring these factors together and ensure their implementation, however, is the innovation dynamic of the US. The effects of the American originality is steadily expressed in the Forbes 200 list, where the US is represented remarkably in the top positions by for example ExxonMobil, General Electric and Wal-Mart Stores (Forbes 2012). The capability for self-renewal, to quickly adapt to changes both international as well as domestic will be the one factor mostly benefitting the US' economy (Scharioth 2012).

4. Strengthened from Outside

One point often underestimated by dollar pessimists is that the US economically exists within the framework of a global system of trade and commerce, a system whose participants have a vested interest in keeping it running. One of the most important actors happens to be China, being economically interdependent with the US and interested in keeping the dollar strong. The relationship between China and the US has been crucially influencing the debate about the dollar in the last decade.

In 2003, Dooley et al. claimed that from the 1990s on, a new unofficial international monetary system, “Bretton Woods II”, had emerged, based on the interdependency between East Asian countries and the West. While Western countries generally imported East Asian goods in great quantities, East Asian countries accumulated reserves and financed the West's fiscal deficits by investing in state securities. Since Asian countries informally pegged their currencies to the dollar, Dooley et al. argued, that this development led to an international position of the dollar similar to the original Bretton Woods.

The strongest interdependency was described by Ferguson and Schularick in 2007 by the term “Chimerica”. From the 1990s on, when the Chinese government started opening the markets, the Chinese economy has largely been based on an export-oriented development supported by an artificially undervalued renminbi. This combined with over-consumption in the US where relatively cheap Chinese goods have been heavily demanded. By investing intensely in US treasuries, China has subsidized American borrowing habits, keeping the export running. Since the Chinese financial system is run by the government, the outsized currency intervention has worked without considerable appreciation of the renminbi. In the early 2000s, the Chimerican relationship accounted for more than a third of the world's GDP (Ferguson & Schularick 2011). In 2011, Ferguson and Schularick postulated the end of

Chimerica, which came about as an impact of the financial crisis 2007-2009, considering it to be desirable because it represents one of the biggest structural imbalances in the world today. However, the Chimerican business practice is very likely to continue for many years.

Firstly, neither the US nor China have economic incentives to let Chimerica come to an end because the mutual economic benefits have been overwhelming. While the symbiosis has enabled China to increase its GDP enormously, China's purchase of US treasuries has helped the US to finance its deficits while maintaining low interest rates, which stimulates the US economy. In the foreseeable future, on the Chinese side exports will stay a crucial part of the economy. The temptation to continue with Chimerican business is especially high in times of economic uncertainty like today's euro crisis. While in July 2012, the Chinese growth rate sank under 8% and exports to Europe decreased, trade with the US went up 10.5% year-on-year to $271.4 billion in the first seven months of 2012 (Xinhua 2012). On the US side, the temptation to rely on large fiscal deficits and money-printing as the traditional remedies for slow growth will stay enormous. Even though private savings have risen during the last months, in times of economic uncertainty and a gridlock in Congress the US government debt will still be increasing and the FED is likely to continue its low prime rate policy. Americans will continue to consume Chinese goods in large quantities, even though protectionist voices in the US may rise from time to time, especially during election periods.

Secondly, China has strong interests in a strong dollar. In fact, during the financial crisis 2007-2009, China questioned its deep financial entanglement with the US. Before the crisis, China's dollar reserves were regarded as a powerful insurance against economic turbulences. During the crisis though, China's officials realized that the country was facing a "Dollar Dilemma" (Dyer 2009). While Mayer and Wübbeke state that "by now, American financial experts steadily have to take their Chinese colleagues into consideration", the "financial marriage" (Ferguson & Schularick 2007) between China and the US has first and foremost caused obvious constraints on the Chinese side. The PBoC had accumulated so many dollars that the country had become highly vulnerable to US monetary policy. Because US treasuries have become relatively expensive (today the US pays only 0.77% of interest on a five-year and 1.78% on a ten-year treasury), gains from interests may likely be annihilated by inflation. China's 2009 proposal to move to a new reserve currency along the lines of the IMF's special drawing rights have shown an increasing nervousness anxiety about their dollar reserves. However, the proposal is politically unenforceable. As has already been argued, any strong signal from the Chinese to divest dollars would drive down the value of China's enormous holdings. In order to avoid immense costs, China can enforce domestic stimulus policies and a renminbi appreciation only very slowly. Indeed, the renminbi gained value during the last years and in 2011, China has allowed the renminbi to appreciate 8% relative to the dollar. However, the renminbi has been depreciating against the dollar since the beginning of this year. In the second quarter of 2012, the renminbi depreciated 0.9% against the dollar, one of the largest quarterly declines since it was de-pegged from the dollar in 2005 (Potter 2012). Facing an economic slowdown due to the financial crisis and recession in Europe, there are strong signals that China will allow the renminbi to depreciate even further. In July, the state-backed China Securities Journal suggests on a front page commentary that, answering to a slowing economy, the renminbi must fall by an “appropriate” amount (Cookson 2012).

Thirdly, there are still powerful reasons for China to buy US treasuries and they are still increasing their holdings. Admittedly, the PBoC has heavily diversified its reserves during the last years, from a dollar share of over 70% until 2006 to 54% in the current year, so that the largest share today is still kept in dollar (Orlik 2012). But even though China’s authorities have started to invest in material goods like energy resources, they have an incentive to maintain a large share of their vast holdings in liquid assets, where there are hardly any alternatives to the dollar. The market for US treasuries is the biggest and most liquid in the world and US treasuries are considered to have hardly any risk. At the same time China has decreased the share of reserves held in dollars, it has still remained a strong buyer of US treasuries. China’s holdings of US treasuries rose 7% to 1.73 trillion dollar in June 2012, a year-on-year increase of 115 billion dollar (Orlik 2012). As long as the dollar maintains a relatively stable and trustworthy currency, China will continue to accumulate its reserve dollars during the upcoming years, and strengthen the dollar as well as the US economy.

5. The US Dollar is Here to Stay

As discussed in the paper, the dollar will remain the only leading global currency in the foreseeable future. While during the last years scholars arguing for a multipolar system of currencies have in turn argued against the dollar, giving the current situation of the world economy, their arguments remain unconvincing.

It is true that the dollar has suffered from the current economic crises, but so have all other relevant currencies. While the other candidates for global currencies, namely the Chinese renminbi and the euro, fall flat, the dollar has remained the comparatively most powerful and trustworthy relevant currency and defended its global status. The dollar has emerged fairly unscathed from every economic crisis since the Second World War, profiting from crises instead of suffering from them. The same cannot be said for its contenders. While the euro is still in its early stages of development and has to deal with its own structural problems before becoming attractive for investors once more, the renminbi suffers from overregulation. The politically mandated undervaluation of the renminbi as a strategical instrument to foster Chinese exports can only be repealed slowly and gradually. A sudden devaluation of the dollar through flooding the market with dollar reserves by the Chinese is theoretically possible, but cannot be intended by the Chinese government, which is much more interested in a strong dollar and until today does not want to take the responsibilities which managing a global currency implies.

Dollar pessimism at the same time has a tradition reaching back to at least the break up of the Bretton Woods System. The decline of the dollar within the next decade has been continuously predicted for the last forty years and it most likely will be predicted well into the future. However, especially in economically uncertain epochs, the dollar has again and again been considered a safe haven for investors. It is the only relevant currency which has the advantage that is has been ingrained in the international system of commerce and trade for decades, based on the long-term macroeconomic stability of the US.

Not only does the dollar appear to be crisis-proof, providing the US with considerable economic advantages, the same can apparently be said for the whole economy. The US economy is today considered by many experts to be on its way to a new boom, albeit a slower one than the ones before. Given the American ability to adapti in order to recuperate losses incurred in economic slumps and their ability to go with economic cycles and recover speedily from them, the US economy traditionally has the best requirements to survive crises.

With no other country able and willing to take the role of managing the dominant global currency, the importance of a better control of fiscal deficits in Washington D.C. is of greatest importance for the global economy’s well-being of the future.

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