America's Dollar Power Politics

By Otmar Issing

It may be weakening the greenback's dominant role as reserve currency.

Since the end of the Second World War, the dominance of the dollar has been the clear manifestation of U.S. economic supremacy. In the dispute over the sanctions against Iran, the Trump Administration is now deliberately using the dollar as a (trade) policy weapon. By monitoring dollar transactions, the United States is able to identify companies that are circumventing the Iran embargo. They have to weigh up whether the threat of exclusion from the American market is too high a risk to take. In most cases, this deliberation leads them to succumb to American pressure and terminate contractual obligations they have undertaken with the Iranian economy.

This is where the dollar unleashes all its power and enables the United States to push through objectives that extend far beyond trade policy. Will this process further strengthen the dominance of the dollar? Or will the U.S. government overextend its position and trigger resistance that could damage the dollar in the longer term?

Discontent over the dominant role of the dollar is by no means a new phenomenon. In the West, French governments in particular have repeatedly attempted to organize a united front against the U.S. currency. In the 1960s, French President Charles de Gaulle tried to persuade the German government to join forces with France in converting their dollar reserves into gold, thereby putting pressure on the United States. This was out of the question for Germany on account of the military protection provided by the United States alone. France's dissatisfaction was later expressed in the complaint of Valéry Giscard d'Estaing, then Minister of Finance, about the "exorbitant privilege" of the United States to be able to cover its

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current account deficit in its own currency. After all, there was an idea—not only in France—that the euro could break the dollar's primacy.

Quite aside from whether such a plan could have been realized at all, as is well known, nothing has come of it. The euro clearly occupies second position in the international monetary system, lagging significantly behind the dollar, and the gap has been widening again in recent years. At the end of 2017, for example, the dollar's share of global foreign exchange reserves amounted to (around) 63 percent, while the euro's share was only 20 percent. The yen (5 percent) and the renminbi (1 percent) followed far behind. Other currencies such as the pound sterling play only a marginal role. In fields such as the financial or currency markets, the gap between the euro and the dollar is smaller, but still considerable.

The basis for the primacy of the dollar in the global monetary system after 1945 lies above all in the economic power of the United States, and not least in its huge and open financial market. As history tells us, leading currencies have only ever been replaced through a very long process. This is mainly due to the fact that they enjoy mutually reinforcing functions as a means of payment, a currency for international financing, and a reserve currency. If companies invoice their export and import transactions in dollars, they must also hold credit balances in dollars or borrow in this currency and carry out foreign exchange transactions using dollars.

On this last point, U.S. policy could end up backfiring. As a global means of payment, the dollar (40 percent) and the euro (36 percent) are now almost on a par. The use of payment transactions to implement (trade) policy objectives is prompting widespread deliberation on whether to avoid American surveillance by invoicing and paying in other currencies. China intends to step up its trials in this area, and the same applies to Russia. The oil business, which has largely been settled in dollars up to now, is a perfect candidate for such an offensive.

This does not herald the end of the dollar's dominance, but reinforces a trend towards a tripolar global economic system comprising the dollar, the euro, and the renminbi. Whether this turns out to be a smooth transition or an abrupt and tense process depends on political developments in the broadest sense. Under the Trump regime, the United States is always likely to spring a surprise. The president has declared several times that he wants to shake up the global post-war order. He seems to favor a strong dollar to defend its leading position and a weak currency for U.S. exports—at least so far with no impact on the dollar. Incidentally, he is not alone in the history of politicians making contradictory statements on the exchange rate.

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The euro has the potential for a much stronger international role. However, before this can materialize, the familiar political and economic difficulties of the eurozone must be overcome. Finally, the renminbi lags far behind China's political ambitions.

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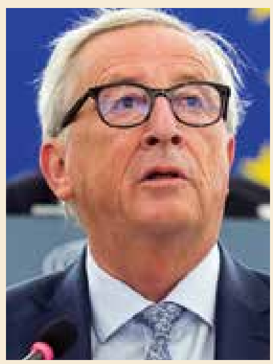
The Face of Europe

In his State of the Union speech to the European Parliament on September 12, Commission President Jean-Claude Juncker revived and advocated the idea of a stronger role for the euro: "The euro must become the face and the instrument of a new, more sovereign Europe." While it is easy to make this assertion, putting it into practice is another matter. The international role of a currency does not heed political appeals. An internally stable euro, a strong eurozone economy, sound public finances, and a globally competitive financial market are the basis for the euro to play a growing role in the global monetary system.

—*O. Issing*



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Jean-Claude Juncker

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The intention of the United States to use the dollar as a political weapon may look like a sign of strength in the short term. In an increasingly multipolar world, however, using the currency to practice power politics can hardly be expected to strengthen global acceptance—in fact, the opposite is more likely. ◆

"Exorbitant Privilege"

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—O. Issing

Charles de Gaulle

Valéry Giscard d'Estaing