Webology (ISSN: 1735-188X)
Volume 17, Number 4, 2020

Role Of The US In International Trade Historical Dominance Of The US Dollar

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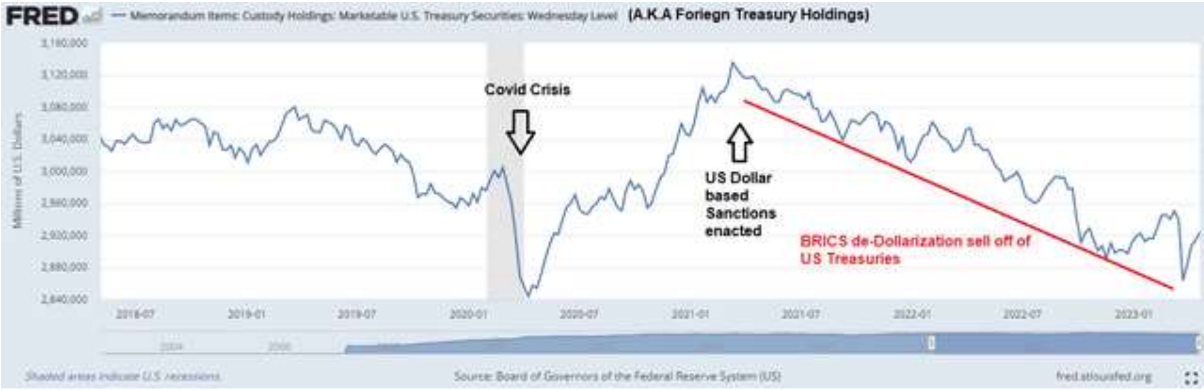
Abstract : This paper examines the pivotal role of the United States in shaping the landscape of international trade, with a focus on the historical dominance of the US dollar. Through a comprehensive analysis of key historical events and economic policies, the paper elucidates the mechanisms through which the US has wielded influence over global trade dynamics.Beginning with the aftermath of World War II and the establishment of the Bretton Woods system, the paper traces the ascent of the US dollar as the world's primary reserve currency. It investigates the factors that contributed to the dollar's pre-eminence, including the economic strength of the United States, its political influence, and the strategic initiatives undertaken to promote the use of the dollar in international transactions. Furthermore, the paper explores the implications of dollar hegemony for both the United States and the global economy. It examines the advantages and challenges associated with the dollar's dominant role, such as its impact on trade imbalances, monetary policy autonomy, and financial stability. Moreover, the paper discusses contemporary developments, including the rise of alternative reserve currencies and the potential challenges to the dollar's supremacy. It evaluates the prospects for the US dollar in an increasingly multipolar world, considering factors such as geopolitical shifts, technological advancements, and evolving trade patterns.By synthesizing historical analysis with contemporary insights, this paper offers a nuanced understanding of the enduring significance of the United States in international trade and the complexities surrounding the dominance of the US dollar.Keywords: United States, international trade, US dollar, reserve currency, Bretton Woods, global economy, monetary policy, hegemony, multipolarity.

Introduction

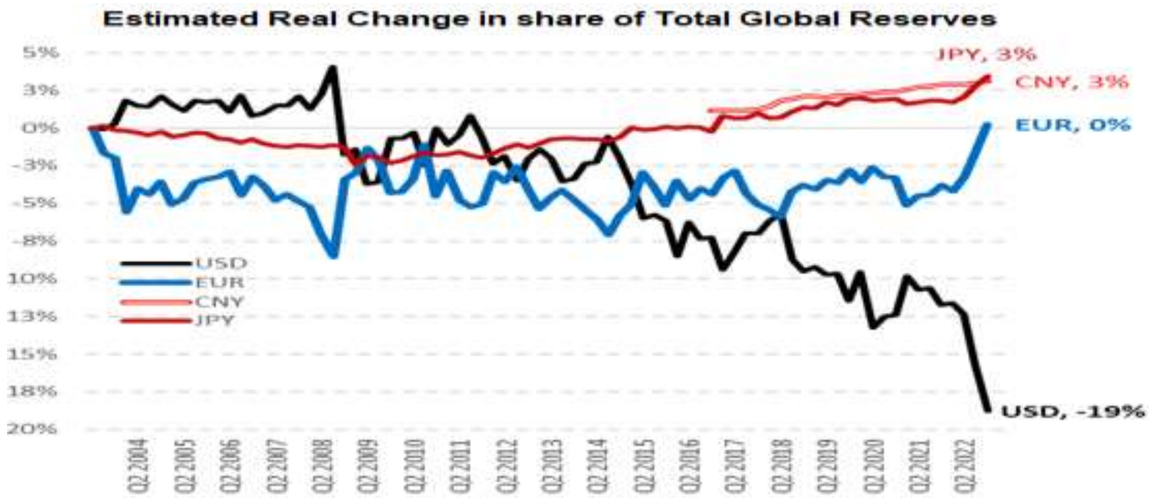
Central Bank Reserve Assets: the US Dollar as an International Store of Value

The US Dollar share of total global reserves in real terms has collapsed from about 66% in 2003, to 55% in 2021, to 47% in 2020. In particular, the 8% US dollar reserves decline over the last year is very concerning as it is roughly 10x the average annual decline over the past two decades. The US implemented currency-based sanctions in response to the Russia-Ukraine war. In response some foreign central banks have been emptying their coffers of US Dollar based assets.



Foreign Treasury Holdings (St Louis Fed)

As you can see below, however, the main reserve replacement hasn't been another major currency (Euro, Yen and Yuan reserves are up <4%).



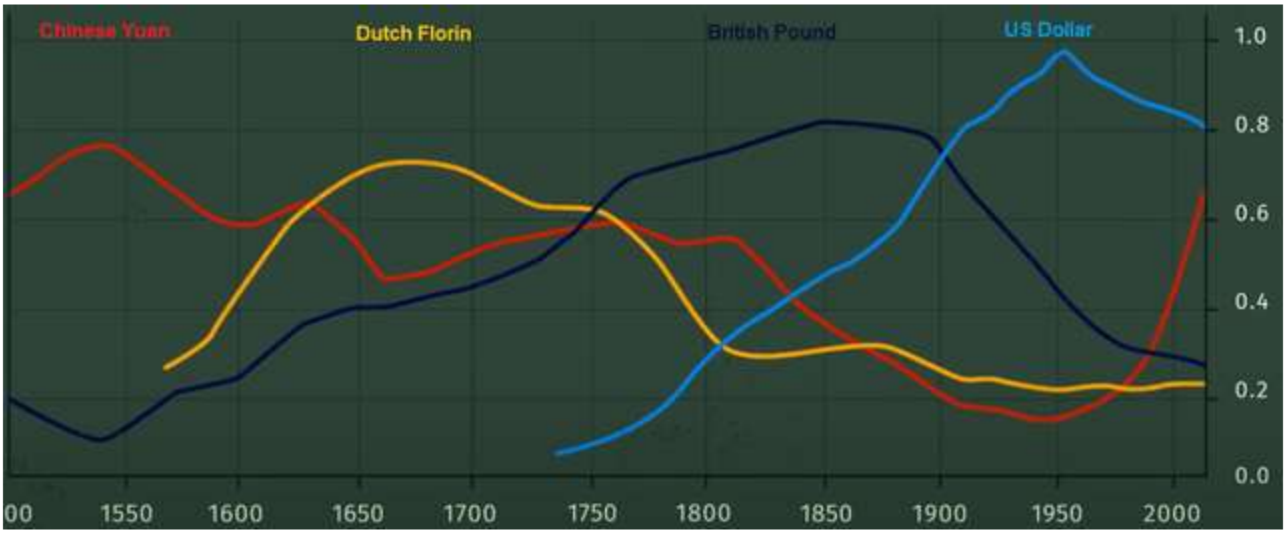
Eurizon Capital

Rather, the main replacement for the US Dollar's decline in central bank reserves over the last year has been gold. 1,136 tonnes were added in 2020, the largest central bank increase in gold reserves on record. With emerging economies such as Russia and China leading the way.

International Transactions:

The US Dollar is still by far the dominant global reserve currency from a transaction point of view. In fact, between 2009 - 2019 it accounted for a whopping 96% of all international transactions. This in turn creates significant and lasting network effects. Basically, people throughout the world accept the dollar because they know others will and have been doing so for their entire lifetime. For now, people throughout the world continue to believe the US Dollar a useful tool for exchange. However, that percentage of global transactions while still high, has also been falling. The latest data available shows it declined from the 96% average previously stated to 88% by April of last year.

This level of decline is not unprecedented. Previous international trade currencies that dominated throughout the centuries have seen something similar. In fact there is a pattern, each of these currencies eventually fell in use as they first turned from asset backed to fiat, and then their percentage of world trade declined. In the chart below we can see over the centuries the Dutch Florin gave way to the French Assign at, which gave way to the English Pound, and then eventually to the US Dollar.

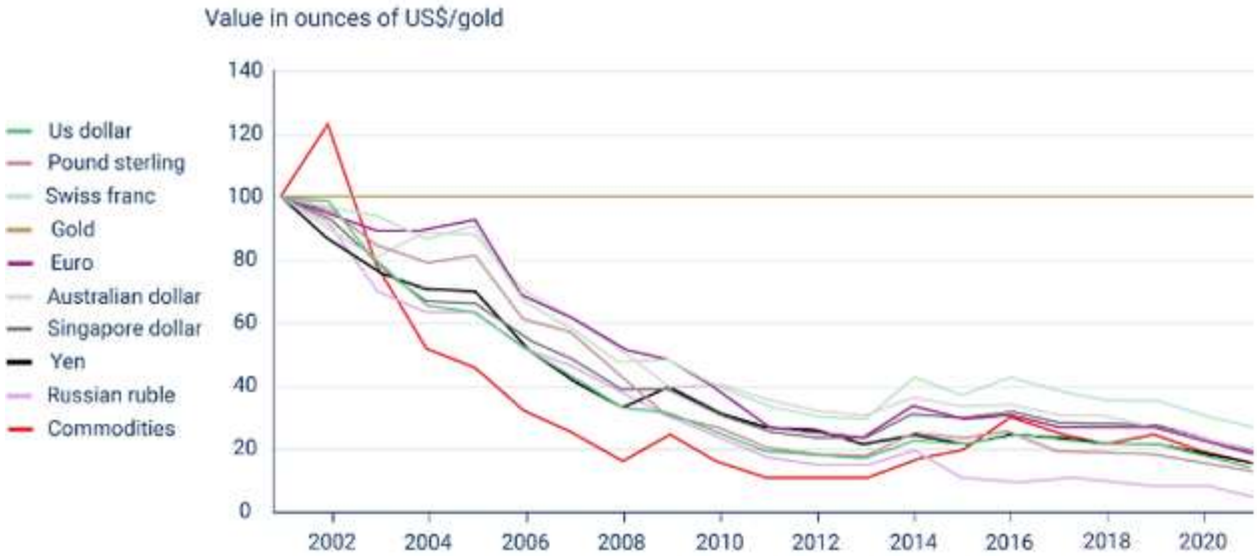


Currency Dominance (Ray Dalio)

Today the US Dollar, while still dominant appears in decline. The Chinese Yuan in ascension. Even more threatening in my opinion, the US Dollar's dominant position may soon also be challenged by a new BRICS currency designed specifically for international trade and backed by hard assets. BRICS is an organization like the G7, only for emerging economies rather than developed. The group which includes -- Brazil, Russia, India, China, and South Africa -- currently encompasses 26% of the world's land, 41% of the world's population, and 32% of the world's GDP (slightly higher than the G7's 31% of GDP). BRICS, however, may also be about to grow. It has been discussing the potential addition of new members, including Middle Eastern countries such as Saudi Arabia, UAE, Egypt, and Iran, as well as South and Central American countries like Mexico and Argentina. This would further increase its importance relative to the US and the G7. The next BRICS meeting is scheduled for August in South Africa, where they are likely to discuss or possibly even announce the addition of new members and the formation of a new commodity-backed currency.

Recent developments also suggest that the BRICS countries have already been making progress in their efforts to reduce their dependence on the US dollar for international exchange. In January 2020, China and Brazil signed a deal to ditch the US dollar for trade, with the two countries agreeing to use the Chinese Yuan and Brazilian Real instead. India has also been offering Rupee trade options to nations facing a lack of dollars. Additionally, Russia has been advocating for the use of a non-US currency in payments between Russia and countries in Asia, Africa, and Latin America. According to Alexander Babakov, the Deputy Chairman of Russia's Duma, Russia's equivalent to the US Speaker of the House is telling the world BRICS is going to form an international, digital, hard asset backed, currency designed specifically for international trade. Believe him.

Some experts believe that this trend towards de-dollarization is due to the declining value of the US dollar relative to real assets such as gold. However, we note there's nothing special about the US Dollar in this respect, the reality is all fiat currencies have been declining in value relative to gold.

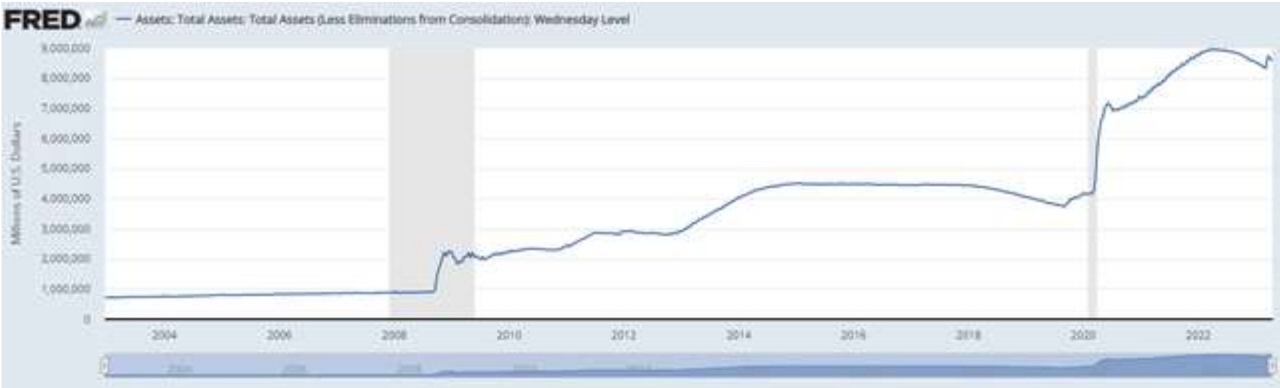


Price of Gold in various currencies (Gold Avenue)

For this reason, a commodity based international currency is particularly attractive (vs. say the Yuan becoming a world reserve currency).

It's really only the US dollar's status as the current global reserve currency that makes it more vulnerable than other countries' fiat currencies. Roughly half of all US dollars in circulation are currently located outside the US. If foreigners and foreign entities no longer want to use dollars for transactions and a store of wealth, those Dollars will come flooding back to the US. This in turn would be felt as a persistent above average inflation rate as more dollars in the US chase the same amount of goods.

I don't however mean to imply it is only foreign influence which will take down the dollar. Rather great economies tend to fall from within. It is our decades of profligate spending, international missteps, and willingness to print ourselves out of troubles, that have created the problem.



Fed Balance Sheet (St Louis Fed)

The dollar is getting weaker, and foreign countries are starting to determine US Dollar hegemony is no longer in their best interests. Yet, BRICS wouldn't have a chance of taking down the almighty US Dollar if we hadn't been sending it in that direction ever since Nixon took us off the gold standard in the 1970's. Get yourself used to the idea now, it may very well happen over the next decade.

Takeaway:

The decline of the US dollar as a world currency is a complex issue with various factors at play. However, the trend towards de-dollarization is becoming more apparent as BRICS nations and other countries seek to minimize their exposure. As the global financial landscape continues to evolve, it remains to be seen whether the US dollar will be able to retain its supremacy for another couple decades.

My point here isn't to scare anyone. Nor do I think the fall of the US Dollar is going to suddenly happen this year. It's always been a gradual process in the past and will likely be this time too. Nevertheless, like anything with high potential loss but low potential chance (e.g. your home burning down), I suggest you buy insurance.

I also seek to forewarn so people have time to educate themselves, get used to the idea and prepare accordingly. My goal is similar to what I did a couple years ago when I warned publicly of inflation, and posted links in my service each week to the cheapest low rate, fixed, 30-year mortgage I could find. Here I'm suggesting you continue to consider inflation friendly hard assets and assets that benefit from higher rates even as those rates are looking like they are about to pause. Here I suggest you do further research and make your own determination.

One great way of preparing would be to borrow in dollars, especially if you can get a low fixed rate, and investing the proceeds in hard assets (gold, real estate, oil, etc.). For now, that opportunity has mostly passed, but we may get one more swing at the ball. If something serious enough breaks, the Fed may not just pause, but then start to lower rates significantly. Even if the Fed just stops raising interest rates, however, US Dollar based inflation will become a greater concern. Hence, at least some hedging now is called for.

Again, I encourage readers to learn more and make up their own mind. Clicking on a few of the dozen links I have provided in this article is one way to do so. The video, "Principles for Dealing with the Changing World Order" by Ray Dalio is a good place to start. Understanding and internalizing big macroeconomic swings like this before they potentially become too stressful helps one to prepare. It increases the chance you will be able to act logically instead out of fear should the challenges/opportunity come to fruition. Editor's Note: This article covers one or more microcap stocks. Please be aware of the risks associated with these stocks. Are you looking for a Reliable Income Stream that beats the rate of inflation? ash Flow Club seeks to produce an overall yield in the 6% - 10% range. We accomplish this by combining several different income streams to form a stable and growing portfolio pay-out. Focusing on corporate cash flows and management capital allocation alignment is a key part of our approach. We then overlaying sound money management strategy that helps income grow while also reducing volatility. Capture an income stream that helps you both beat inflation and stay logical when times are uncertain. Start your free two-week trial today! The US dollar's dominance in global trade and finance The US dollar is currently the dominant currency in global trade, accounting for approximately 85% of all foreign exchange trades. There are several reasons for this, including:1. Strength and Stability of the US Economy Despite trillions of dollars in foreign debt and continuous large deficit spending, the United States still holds global trust and confidence in its ability to pay its obligations. As the US economy has weathered all economic storms that have come its way while also being the largest and most highly stable economy in the world, it provides a sense of security and instils trust among investors globally.2. Role of the US in International Trade The US is one of the largest importers and exporters in the world. As a result, many international transactions are denominated in US dollars. This usage has made the US dollar the go-to currency for many countries that engage in global trade.3. Historical Dominance of the US Dollar Since the end of World War II, the USD has been the dominant currency in global trade. Many countries have established their currencies' exchange rates with the US dollar, which further cements its position as the leading currency in global trade.4. Size of the US Financial MarketsThe US financial markets, including the stock and bond markets, are among the largest and most liquid in the world. This makes the US dollar an attractive currency for investment. When investors want to buy or sell stocks or bonds, they need US dollars. Thus, the size of the US financial markets has contributed to the US dollar's dominance in global trade. 'World' Economy on the Greenback! What's 'greenback' you might be pondering? Greenback's dominance started in 1914 when the Federal Reserve Bank was created, and the US printed its first paper currency aka 'Greenback'. It gave the US a major stake in the global financial system. Since then, the US dollar has become the world's most widely held reserve currency, accounting for over 64% of all foreign exchange reserves held by central banks worldwide But lately, things have been changing. The dollar's share of global foreign exchange reserves has been declining in recent years, despite it remaining the dominant global reserve currency. This is perplexing to analysts and investors alike. The US dollar became so dominant due to the positioning of the US economy right at the top – its stability, openness to trade, and capital flows. It has also had strong property rights and the rule of law. This allowed the US to borrow money more easily and impose painful financial sanctions on other countries. This dominance imposes its fair share of challenges on the US economy. When foreign central banks stockpile dollars, they effectively push up the purchasing power of American consumers. This can make it harder for US companies to compete in international markets. he US dollar exchange rate has also become increasingly politicized, with calls for a weaker exchange rate to boost employment and exports. This is adding to the perplexity of experts who are trying to understand the implications of these changes .Global banks hold a significant amount of US dollar-denominated liabilities, which have been steadily increasing since the Global Financial Crisis. The only other currency with a notable amount is the euro, with over $9 trillion of foreign-denominated bank liabilities.

Recent trends show a decline in the US Dollar Index, which measures the performance of the greenback against a basket of other currencies, including the euro, Japanese yen, British pound, Canadian dollar, Swiss franc, and Swedish krona. The US dollar’s role in the world economy remains complex and multifaceted, with ongoing debates about its future trajectory and potential challenges it may face in the years ahead. Every finance literate needs to stay informed about these trends and their potential implications for our future. Who knows what kind of exciting developments we may see in the coming years? Geopolitical issues and it’s impact on the Debt Market The pros and cons of the US dollar’s global dominance One of the primary benefits of the dollar’s dominance is that it is widely accepted in global trade, giving the US a significant advantage in international commerce. The dollar’s status as the world’s reserve currency also allows the US to borrow at low-interest rates. It stimulates economic growth and provides flexibility in responding to financial crises. Some economists go on to argue that the US dollar’s dominance has helped to maintain stability in the global economy.
The dollar’s global dominance also has its downsides. The global economy is highly susceptible to swings in US monetary policy, as the Federal Reserve’s decisions affect the monetary policies of countries that link their currency to the dollar. The dominance of the US dollar has also led to concerns about the potential negative effects of the country’s large trade deficits and debt levels on the global economy .In this decade, some have even suggested that the US dollar’s dominance may be challenged by the rise of digital currencies, particularly as more countries explore their own central bank digital currencies (CBDCs). There’s a growing recognition that the global economy could benefit from a more diverse range of reserve currencies, which would help reduce the risks associated with any one currency’s dominance. Fluctuating Fate of the Dollar and Rupee As of March 9, 2020, the exchange rate between the Indian rupee and the US dollar was 0.0121, which means one US dollar was equivalent to 82.49 Indian rupees. The reason for the fluctuation is that, as per the laws of demand and supply, the value of the rupee increases against the dollar when the demand for the dollar is high. A fall in the rupee against the dollar can have an impact on an investor’s US stock portfolio. A lot of forexes analysts are currently attributing the depreciation of the rupee to the recent hike in US interest rates. Although, that is just the short-term outlook and will not continue for long as India remains the fastest-growing economy.
The Indian government also has started paying for most Russian oil in non-dollar currencies, denting the decades-old dollar dominance. This follows a move by a coalition opposed to the war to impose an oil price cap on Russia.The depreciation of the Indian Rupee against the US dollar can lead to an increase in the prices of essential goods and services, as India needs to pay more for the same items. The strength and weakness of the dollar can impact the

profitability of Indian companies, which either earn a large chunk of their revenues in dollars or import key raw materials. Foreign fund flow into Indian equities is dictated by the currently accepted investor sentiment which is generally dictated by the trend of appreciation or depreciation of the INR/USD duo.Despite the challenges posed by the fluctuations of the US dollar, Indian Finance Minister Nirmala Sitharaman remains optimistic about the resilience of the Indian rupee. She has noted that the currency has performed better than many other emerging market currencies and even a 10% slide in its value may not be a cause for concern.
Recently the Indian currency plunged against the US, although the Indian economy can show a significant growth projection in its GDP in the near future. That may happen if the Government essentially enhances the financial sector. The changes can be possibly made to strengthen the debt market (Bond) for larger firms and the banks can lend money to the SMEs in order for them to emerge. The report from the Centre for Economic and Business Research, predicts that the Indian economy can overtake Germany by 2031 to become the World's third-largest economy. The Dark Side of Dollar Dominance: Unintended Consequences for the US Economy Firstly, it has been noted that the decline in the dollar's share of international reserves since the turn of the century is not solely due to changes in exchange rates and interest rates or reserve accumulation by a small handful of central banks. Rather, it reflects active portfolio diversification by central bank reserve managers. This trend toward diversification may continue and could lead to a further decline in the dollar's share of international reserves.
Secondly, there are concerns about the impact of dollar dominance on the US government's ability to run large budget deficits with impunity. The dollar's status as the world's reserve currency has allowed the US to borrow at lower costs and run larger budget deficits.
The US government has recorded a budget deficit of $421 billion for the first quarter of the fiscal year 2020, which covers the period from October 1, 2020, to December 31, 2020. In January 2020, the federal government recorded a budget deficit of $39 billion, compared to a surplus of $119 billion in January 2020. The total deficit for the 2020 calendar year was $1.42 trillion.President Joe Biden's upcoming budget proposal aims to cut deficits by nearly $3 trillion over the next decade, indicating that the US government is still dealing with budget deficits in the future.A decline in the dollar's dominance may lead to higher borrowing costs and reduced ability to run large deficits, potentially constraining the government's spending.
Thirdly, there are concerns about the impact of digital currencies on the dollar's dominance. The rise of digital currencies, such as Bitcoin and other cryptocurrencies, has the potential to disrupt the dominance of the US dollar. If the use of digital currencies continues to grow, it may reduce the demand for the US dollar and weaken its position as the world's reserve currency. It is clear that cryptocurrencies continue to be a topic of interest and speculation among investors and financial experts although, it remains to be seen how cryptocurrencies will impact the US dollar in the futureFinally, it has been suggested that the dominance of the US dollar gives the US government unprecedented insight into the functioning of the international economy. The potential loss of this insight could have unintended consequences for US economic policymaking.While the unintended consequences of dollar dominance on the US economy are complex and multifaceted, it is clear that there are potential risks associated with the decline of the dollar's dominance.

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