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After dollar?

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Abstract

The national currency of the United States, the dollar, plays a critical international role. The privileged position of the dollar, which has greatly facilitated America's role in world politics, is now being questioned. This article argues that the international monetary system tends to be based on hegemony rather than super-sovereignty or multiplicity, and that no serious challengers to the dollar's hegemony have yet emerged. The dollar's predominance, however, is weakening and it has turned into a 'negotiated currency'. If its international roles are to be sustained, the dollar needs to be actively supported by other major economies. 'Negotiation' may fail as rising economies, most notably China, represent American political challengers rather than subordinate allies. Should the dollar cease functioning as the reliable international currency, in the absence of an alternative hegemonic currency, the world could see a more fundamental shift, such as the wider use of private international currencies.

1 Introduction

The roles of the dollar in the international monetary system have been actively discussed since the outbreak of the Lehman crisis. 'The one reserve currency has become a danger to the world economy: that is now obvious to everybody', said Russian prime minister Vladimir Putin at the World Economic Forum in Davos in January 2009, calling for a

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system of multiple reserve currencies, questioning the 'reliability' of the US dollar as a safe store of value.[1] Shortly before the G20 meeting in London, Zhou Xiaochuan, the Chinese central banker, published an article in which he called for the creation of a 'super-sovereign reserve currency' to curtail the roles of the US dollar as international currency (Zhou, 2009). On the other hand, Japan, which is the second largest official foreign exchange reserve holder, is adopting a different attitude. Rintaro Tamaki, the vice minister of finance for international affairs, was reported to say that Japan would continue to hold its foreign currency reserve mainly in the form of dollar assets and that the system based on the dollar would continue in the foreseeable future.[2] Japan, however, unlike China, lets its currency freely float and thus is more vulnerable to the depreciation of the dollar. Therefore, it is of no surprise that there are growing concerns about the value of the dollar even in Japan. The BBC, for example, reported in May 2009 that Masaharu Nakagawa, the chief finance spokesman of the Democratic Party of Japan, which later came into power, said that he was worried about the future value of the dollar and proposed that the United States issue government bonds denominated in yen.[3]

In addition to the credibility and stability of the value of the dollar, there is a strong argument that the US financial excess that triggered the current crisis was closely related to the predominance of the dollar as the international key currency. Namely, its role as the international transaction currency has made it possible for the United States to borrow excessively from abroad, by which the United States could finance its huge current account deficits. In addition, it allowed US financial institutions to enjoy enormous comparative advantages in the global financial market and to make enormous profits by selling dubious financial instruments all over the world, thereby dragged the whole world into the financial mess. Whether this claim is right or not, the dollar's roles in the international monetary system are

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1 *The Daily Telegraph*, 29 January 2009.

2 Reuter, 17 July 2009, downloaded from http://jp.reuters.com/article/forexNews/idJPJAPAN-10109220090717.

3 'Japan 'would avoid dollar bonds', 12 May 2009, downloaded from http://news.bbc.co.uk/2/hi/business/8046599.stm.

evidently asymmetrical in a sense that while it plays important international roles, it is basically the American national currency exclusively under the control of American monetary authorities that manage the dollar in pursuit of American national interests. Thus, it is of no surprise such imperial status of the dollar is questioned in a world where sovereign states are operating under the principle of sovereign equality.

As a matter of fact, this is not the first time the special roles of the dollar have been widely questioned. As far back as the early 1960s, when the chronic US balance of payment deficits started to be seen as a problem, a variety of reform proposals were put forward and discussed. In the mid-1960s, France openly criticized the dollar's role calling it 'an exorbitant privilege'. It even tried to challenge the dollar's status by converting its official dollar holding into gold and withdrawing from the gold pool mechanism, which was aimed at stabilizing gold price in the private market by pooling official gold reserve of major countries. In the 1970s, after the collapse of the Bretton Woods regime, it was widely believed that as the world was becoming increasingly multipolar, the global financial system should also be more pluralistic to better reflect the new pattern of distribution of economic power. In the 1980s, when the United States' current deficits grew to an unprecedented level, which made the United States a net international debtor, the dollar's dominance seemed to be undermined. 'The fact that so much Regonomic debt was financed by borrowings from Japan has planted a ticking bomb. The threat of a Japanese pullout from the US bond market gives Tokyo meaningful leverage in bilateral negotiations over trade, defense, and other issues – leverage it is already beginning to use. International unease over American creditworthiness is also beginning to dim enthusiasm for dollar assets and raise questions in the minds of global bankers as to whether the dollar can or should continue to be used as the world's key currency' (Berstein, 1988, p. 137).

However, in each case, despite the widely discussed decline of the dollar, its pivotal roles remained intact. In fact, the dollar's dominance in the international finance had been practically unquestioned since the mid-1990s when the US boom started and massive American current account deficits were largely forgotten or regarded as representing confidence in the US economy held by foreign investors pumping their capital into the dollar financial assets.

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This article attempts to discuss the sustainability and possible changes of the current international monetary system based on the special status of the dollar. In doing so, the author relies mainly on history of international monetary relations as well as past discussion on reform proposals. It is hoped that we can better judge where we are in history after the Lehman crisis which was called as an event that occurs once in 100 years.

We will first briefly discuss the costs and benefits of the issuing country of the key currency to see how the dollar's hegemony in international finance is related to American political hegemony in the world. We then turn to possible alternatives to the current hegemonic system based on a predominant national currency. It will be argued that there is a natural tendency for an international monetary system to be a hegemonic one. We then discuss the current status of the dollar. Although we see that there is no national currency that can replace the dollar in the foreseeable future, I will finally try to speculate possible ways that the dollar's dominance could end and what could possibly follow in the world after the dollar.

2 Privileges of the key currency

President Kennedy, in examining the possible reforms of the Bretton Woods system in facing gold drain from the United States in the early 1960s, asked his advisers about the merits of having the dollar as the key currency saying, 'I see the advantages to us as part of the Western world to have a reserve currency, and therefore it's an advantage to us as part of the Western world, but what is the national, narrow advantage?' (Gavin, 2004, p. 86). About 10 years later, when the United States unilaterally suspended the gold convertibility to press the other major economies to revalue their currencies, John Connally, Secretary of the Treasury, behaved as if the extensive overseas use of the dollar is a nuisance for the United States saying, 'The dollar is our currency but it is your problem' (Volker and Gyohten, 1992, p. 121). Do the roles played by the dollar represent privileges or burdens for the United States? It may not be surprising that Americans tend to see supplying the international money as their responsibility or in some cases as the international public goods supplied by the United States on which foreigners are merely free-riding. But standard economic arguments tell us there are following tangible

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advantages to be the issuing country of the key currency (Aliber, 1964; Cohen, 1971; Bergsten, 1975, chapter 7; Arima, 1984, pp. 217–219).

Because the dollar is widely accepted as a means of transactions and held widely by foreigners as storage of value, the United States can and indeed has been running huge current account deficits without any immediate pressure for adjustment of its balance of payments. Other countries with large current account deficits cannot escape the need to balance its external position. Adjustment usually involves devaluation of its currency and/or austerity measures cutting domestic demands by tighter budgetary and financial policy. They are generally painful policies both economically and politically. Given the fact that almost any country in the world has bitter experiences for balance of payments adjustment in the past, this can be seen as a significant privilege. Indeed, it is difficult to imagine that the United States, by far the largest debtor in the world, can run such large current deficits unless its currency happens to be an international currency, or the key currency. Without this special status of the dollar, no country would be able to run as large and persistent current account deficits as the United States without causing a currency crisis. Because of the dollar's special status, the United States has largely been free from this type of discipline that all other countries are subject to.

The United States has also been enjoying seigniorage because of the extensive use of the dollar as storage of value. This takes many different forms. First, a large portion of foreign dollar holdings are held in the form of Treasury Bills for which Americans pay only low interest rates. In other words, because of its key currency role, the United States can automatically secure low interest rate credit given by foreigners to finance its imports, its military presence abroad, and its direct investment overseas. At the same time, since the United States can settle foreign transactions with their own money, there is no such a thing as exchange rate risks for Americans. Moreover, since they can borrow extensively abroad with their own currency, technically there is no risk of default as they can ultimately simply print as much money needed to meet the claims by foreigners. They actually have been writing off their international liability by devaluing their currency since the early 1970s when the nominal exchange rates of the dollar were much higher. Also working dollar cash balances held by foreigners do not bear interest. This also represents seigniorage for the United States.

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The dollar's international roles also facilitate the US banking industry to do business in international markets. Since US financial institutions have the best access to the dollar deposits, they have natural competitive advantages in dollar-based financial business. Also by meeting financial needs all over the world through the dollar, American financial market can enjoy economies of scale. In other words, because of the dollar's international roles, American financial markets can be larger and deeper, which in turn makes the US financial system more efficient and US financial sectors more competitive than otherwise. The dollar's international roles, therefore, constitute an important subsidy for the US financial sector.

On the other hand, there are some disadvantages, as well. First, because the dollar is used extensively all over the world, there is additional demand for the dollar which overvalues it than otherwise. The overvaluation of the dollar puts the US manufacturers in a disadvantageous position in the international market. Also, in order to maintain its key currency roles, the US financial market must always be wide open to international holders of the dollar. But large amounts of foreign dollar holdings with ready access to US financial market make the United States potentially more vulnerable to international financial environments. In addition, it would be more difficult to control money supply if the money is held and can be sent back home rapidly than if it is held only at home. It is exactly for this reason that some countries such as Japan and Germany discouraged rather than encouraged foreign holdings of their currencies at some point.

In the long run, the very short-term advantage mentioned above could be damaging to the United States. If one can run current account deficits too easily, this would encourage the country to borrow too heavily from abroad. This could charge the United States with more long-term debt services than otherwise. It can also be argued that the very ease for the United States to borrow money encourages the United States to make excessive international political commitment. This would, in the end, drain American political and economic resources (Calleo, 1987).

It should be remembered that neither the dollar nor sterling became the key currency through political coercion. No political coercion or even an agreement was needed to have the sterling circulate all over the world. Likewise, the international demands for the dollar were constantly

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strong after World War II (WWII) up until the late 1950s when the world was obsessed by dollar shortage instead of dollar glut. The dollar after all became an international currency by selections of its private holders in their pursuit of their own interests. Thus, international status of dollar was largely driven by demands of its international users for its unquestionable credibility.

For smooth international transactions, it is always better for us to have some international currency than none at all. It is easy to imagine how cumbersome it is to make international transactions without a single medium for exchange which is backed up by efficient and deep financial infrastructure. The dollar was a natural choice for the key currency in the 1950s when the US economic supremacy is unquestionable. It was only the dollar that was fully convertible and it was only the United States that could provide foreigners with access to its financial market. The dollar was never imposed against the will of the followers. The dollar, in this sense, was the 'Top Currency' which is 'the choice of the world market. It derives therefore, from the issuing state's position of economic leadership which inspires monetary confidence even among political opponents' (Strange, 1971, p. 5). The dollar was crowned not by American political pressure but simply because it was widely trusted by the world. If there was a complaint on the part of Western American followers, it was dollar shortage not the dollar glut.

But as its underlying overwhelming economic supremacy waned in the 1960s, the United States found itself in a position to use political leverage to defend the roles of the dollar. It was no coincidence that both Japan and Germany, the most obedient US Cold War allies, were most supportive to upholding the dollar by accumulating official dollar balances and accepting dollar's depreciation (Spiro, 1999). Particularly, Washington kept putting pressure on Bonn to hold onto the dollar reserve as well as to offset American foreign exchange costs of US troops deployed there (Gavin, 2004). By the late 1960s, converting the dollar into gold became practically impossible among major American allies. Germans even formally agreed not to convert their dollar reserve into gold in 1967. This was another way for Western allies to subsidize American Cold War strategy, which ultimately underpinned their national security. At this point, it could be argued that the dollar was a 'Master Currency' whose international role was dictated more by 'political dominance or hegemony' (Strange, 1971, p. 22).

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After the dollar's link with gold was unilaterally cut by the Nixon Administration in 1971, dollar became merely the de facto key currency with no formal arrangement to privilege it. Dollar's relative values to the other currencies have been primarily determined by market since major currencies started floating with the dollar in 1973. Formally, even the dollar would be subject to exactly the same discipline imposed by markets. A free floating exchange rate system without any official intervention lets national currencies compete with each other in foreign exchange market. If the selection of international money is made without any official involvement, in theory, the US abusion dollar's status would be punished by market, thus financial disciplines would also effectively be imposed on the United States.

This obviously was not what actually has happened. The dollars have continued to be widely used by private economic actors largely because dollar's dominant position in international financial markets has been deeply entrenched and institutional inertia was there. Also, so-called network externality was at work. It is always more convenient to use money that are widely used by others. Thus, there is strong tendency that markets will select a single, dominant money. Like English has become increasingly overwhelming linga franca not by deliberate efforts by the UK or US governments but through market selection, dollar's hegemonic status has been maintained as a result of.

Also since the 1990s, the dollar's special position has been sustained by some national governments that keep accumulating the dollar for their official reserves. 'The privileged position of the dollar survived the collapse of the Bretton Woods regime of fixed-exchange rates in 1971. In theory, the resulting system of floating exchange rates removes the need for any reserves at all, since adjustment of current account imbalances was supposed to be automatic. But the need for reserves unexpectedly survived, mainly to guard against speculative movements of short-term investment—"hot money"—that could drive exchange rates away from their equilibrium values. Starting in the 1990s, East Asian governments unilaterally erected a "Bretton Woods II," linking their currencies to the dollar, and holding their reserves in dollars' (Skidelsky, 2009, p. 33).

Thus, while exchange rates among major economies were agenda for multilateral negotiations from time to time, pivotal roles of the dollar as the international currency were largely intact which has clearly facilitated American international political roles. Although there is no formal

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arrangement to endorse such special roles played by the dollar, the system has privileged the United States. By letting its own currency circulate internationally, the United States could easily and cheaply finance its military presence abroad, its international aids, and even its international direct investment. Thus, the dollar's special status facilitated American political hegemony by allowing the United States to run massive current account deficits, to enjoy seigniorage, and to benefit from having a dominant position in the global financial business.

It is hardly surprising that countries other than the United States do not find this arrangement that obviously privileges the United States completely satisfactory. When the dollar looks stable and trustworthy, it could be seen as public goods. But once its credibility is questioned and costs and burden are involved in sustaining its hegemony, it is all too natural that alternative intentional monetary arrangements to dollar's hegemony are sought after.

3 Alternatives to hegemony

3.1 Super-sovereign currency

If the problem of international monetary system lies in the very fact that a national currency is playing international roles, the best logical solution would be to introduce supranational control of the international money. In 1988, the *Economist* predicted, 'Thirty years from now, Americans, Japanese, Europeans, and people in many other rich countries, and some relatively poor ones will probably be paying for their shopping with the same currency. Prices will be quoted not in dollars, yen or D-marks but in, let's say, the phoenix' (The Economist, 1988). Twenty years later, are we any closer to what was predicted?

Indeed, many European national currencies including D-mark were replaced by the Euro, which is a regional super-sovereign currency. It seems, however, that the European monetary union is more of an exception rather than a rule. A monetary union is a very demanding and time-consuming attempt. 'Few states share enough group loyalty to make the requisite sacrifice of monetary sovereignty and even those who might be prepared to make the commitment, willing partners are hard to find' (Cohen, 2008, p. 309). For example, East Asia including China and Japan, the two largest dollar holders in the world, could share interests

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in forming a currency union to defend themselves from instability of the dollar. But, currently, there is no settle. Thus, even when renminbi (RMB) and yen are converted, the transactions are made through the medium of dollar (Nakakita, 2009). True, Asian regional financial cooperation has been expanding substantially since 1997–98 Asian Financial Crisis (Tadokoro, 2003). As is well illustrated by China, objection to Japan's proposal to set up Asian Monetary Fund in 1997, the political-level regional cooperation comes far short of the one needed to create a common currency. Given enormous political and economic differences among countries in the region, development of regionalism after the European model is simply unrealistic (Grimes, 2009).

More importantly, regional monetary unions would not solve the critical problem of interregional global monetary relations. What is currently being questioned is how East Asian and Arab creditors related themselves to the dollar. Given the critical importance of interregional capital in determining the future roles of the dollar and American political roles implied in it in the global context, regional monetary integration will not address the problem.

Some of the dollar's international functions, however, could be replaced by creating a global super-sovereign currency. For example, the aborted Keynes Plan envisaged an international reserve asset called Bancor. Its idea was to clear balances of international payments, thereby giving incentives to both surplus and deficit countries for adjustments (Keynes, 1980 p. 76). This probably would have been technically better than the actual Bretton Woods System as it could have corrected payment imbalances among major economies in the 1960s by allowing the United States to devalue the dollar in an orderly way. However, the plan was rejected by the United States which ironically thought the Keynes plan would be too accommodative to deficit countries while it was too tough for surplus countries.

Currently there is a call for wider use of Special Drawing Rights (SDR). As was already mentioned in Introduction, China called for introducing 'a super-sovereign reserve currency', which is 'disconnected from individual nations' and went on saying 'the scope of using the SDR should be broadened, so as to enable it to fully satisfy the member countries' demand for a reserve currency' (Zhou, 2009). SDR, which was introduced in 1969, could be called a supranational currency. It is distributed and administered by the International Monetary Fund (IMF) and

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its value is calculated by a weighted average of major currencies. Thus, it is freer from arbitrary policy of any single issuing country. It is an irony to see China which is usually most insistent on sovereignty preaching the merit of super-sovereign currency. But it is true wider use of SDRs could make the system more symmetric. SDR is already used as the units of account by IMF and its allocation may have been meaningful resources for developing nations. The problem, however, is in the view of the fact that it has never been widely used in private markets, it is unlikely that SDR can be serious competitor to the dollars.

Logically, a single global currency managed by truly global mechanism would offer the best solution to problems related to international financial architecture. Its difficulties, however, are also well known and decisive. As long as management of money is related to distribution of wealth, it can never be reduced to a technical matter. Supranational monetary cooperation, therefore, requires commensurate political integration, which is simply utopian in the foreseeable future. While SDR's roles can expand further, values of SDR are ultimately underpinned by national currencies of member states. It is highly unlikely that IMF, which is after all an association of member states with no power of its own, looks more trustworthy than the national governments.

3.2 Multiple key currencies

If the hegemon is inclined to abuse its privilege to the extent it endangers the soundness and stability of the whole system, checks and balance provided by a multipolar system may inject necessary discipline into the system reducing the likelihood of hegemonic monetary excess. After all even currently the United States represents only 25% of the world GDP and more pluralistic elements are natural ingredients in international monetary order as well. In addition, many economic projections predict that in a generation, China and possibly India will surpass the United States in their total economic sizes. The Euro-zone can be also counted as one of monetary poplars that could check and balance the United States. In fact, some European policy-makers are explicit on this point. 'EMU will also means that the Community will be better placed, through its unity, to secure its interests in international coordination processes and negotiate for a balanced multipolar system' (Emerson *et al.*, 1992, p. 11).

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If the world is multipolar, it is natural for us to expect some multipolar elements in the international monetary system. With the rise of new powerful international currencies, the US authority also can no longer keep abusing its hegemonic position. Because if dollar's confidence is questioned, then the United States will feel the pressure by seeing rapid outflows of capital and steep depreciation of the dollar. In fact, for some time after WWII, sterling played roles of international currency along with dollar mainly for Commonwealth countries (Schenk, 1994). In the 1970s, there was a talk of the trilateralism in international money, namely in addition to the dollar, DM and the yen would be more widely used and would become semi-key currencies in their respective zones. While what has actually happened was continued predominance of the dollar, now the Euro could be a more globally competitive alternative to the dollar. In fact, some countries are diversifying their reserve and increasing their Euro holdings. While the Japanese economy is in decline, perhaps the RMB and possibly even the Rupee may challenge the hegemonic position in the long run.

Historical experiences of multiple key currency system, however, are not inviting. It can be highly volatile as massive capital lows can take place from one currency to another. Bimetarlism in the United States was a major source of monetary instability. Besides, in the highly globalized world, where global capital flows are very intensive, the system will hardly function better than the current dollar-based system.

More importantly, a single money is always more convenient than more than two monies since it reduces information and transaction costs. Thus, economic players have strong incentives to choose one currency more widely in circulation. In other words, there is a network externality at work in selection of money, where the very fact it is being widely used works as a strong inducement to choose the currency. Thus, there is a strong tendency to privilege a single key currency rather than two or more. With global financial market more integrated today, a multiple key currency system is neither attractive nor easy.

3.3 Denationalized currency

Another way to bring in more symmetry into the system is to denationalize the currency by using politically neutral money to remove arbitrary national control of the international currency. One way to denationalize

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money is to return to commodity currency. Typically, a call for return to the gold standard falls into this category. Gold cannot be printed like national currencies. Once national currencies are made convertible to gold, budget deficits will be difficult to finance, which would entail stability of prices. Although the classical gold standard is largely regarded as mere nostalgia of the good old days, it attracts attention when trust in national currencies is shaken. In the 1960s, France tried to promote gold standard (Rueff, 1971). President De Gaule said that international trade should be based on 'an unquestionable basis that does not bear any stamp of any one country in particular. On what basis? Truly it is hard to imagine that I could be any standard other than gold, yes, gold whose nature does not alter, which may be formed equally well into ingots, bars, or coins, which has no nationality, and excellence' (Solomon, 1982, p. 55).

As late as 1981, President Regan set up the Gold Commission to look into possibility of reintroduction of the gold standard.[4] In fact, gold is still widely used as storage of values in many parts of the world where national currencies are not trusted. In the international market, gold prices tend to reflect the level of mistrust toward the dollar. Its merit as the basis for international money lies in the belief that the value of the gold is based on its inherent value. Thus, it cannot be manipulated by selfish national policies. Once it is agreed that national currencies are based on some commodity like gold, a large part of international monetary system is left to automatic regulation of private markets as national financial policy would be guided by flows of gold. Thus, there would be no more hegemonic privilege of the issuing country of the international currency with politically neutral commodity as the centre of the system.

Another approach is to abolish the state monopoly of issuing money. Friedrich von Hayek, for example, argued that the government monopoly of the issue and control of money must be abolished and let the market choose the best money as they see. This would impose discipline upon governments that tend to abuse their monopolistic position which has often caused inflation. By letting a variety of monies compete with each other, the government would lose power to quietly depreciate its money to enjoy seigniorage. Also 'With the disappearance of distinct territorial currencies there would of course also disappear the so-called

4 'Reagan Names Gold-Role Unit', *The New York Times*, 23 June 1981.

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'balance of payment problems' which was believed to be causing intense difficulties to present-day monetary policy' (Hayek 1976, p. 103).

The gold standard, however, may be able to get rid of arbitrary manipulation of money by a national government, but it will introduce another arbitrariness because money supply will be determined by the highly contingent increases and decreases of supply of gold. Supply of gold could increase by discovery of new mines or development of refining technology with no connection to economic needs. If so, the gold standard itself will need to be managed politically to make it workable. In fact, after WWI as gold was so heavily concentrated in the United States, its price was largely dependent on the deliberate policy of the US authority. 'Gold itself has become "managed" currency' (Keynes, 1971, p. 135).

Politically given enormously uneven distribution of gold stock, for many countries with limited amounts of gold stock will not find the idea attractive. More importantly, it is hard to imagine that national governments, including that in the United States are prepared to do without their seigniorage by linking their national currencies to the gold or by giving up the territorial monopoly of issuing money. Whatever technical advantages of the idea maybe, it requires almost revolutionary political energy to have national governments give up their managed national currencies.

Denationalization also assumes that market mechanism is largely self-regulative and private institutions are more credible than state-run system. Such belief in markets seems to be less convincing after the Lehman shock. More importantly, for better or worse, today's national governments simply cannot afford giving up their control of money and standing by when market disfunctions like financial crises spread, if even it is better in the long run to do so. History of capitalist economy is full of episodes of currency and banking crises. Many supervisory devices have been set up to prevent the crises (Kindleberger, 1978). Despite the efforts, however, financial crises seem to have become more frequent and severer (Bordo and Eichengreen, 2002). Even before the Lehman crisis, there were Latin American debt crises in the 1980s, Mexican financial crisis in the 1993–94, Asian Financial Crisis in 1997–98, subprime mortgage crisis in 2007 to name just a few notable ones. In each case, in order to stabilize financial market, public authorities are required to step

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in to supply liquidity and to organize bailouts of private financial institutions with increasingly larger amount of tax money.

4 The dollar as a negotiated currency

The proceeding discussion suggests that there is natural tendency for the international monetary system to be a hegemonic one. If it has to be hegemonic, the dollar is still the natural hegemonic currency at this juncture of history. At this juncture of history, there simply is no national currency that can readily replace dollar's hegemonic position. Although Euro is the only possible alternative to the dollar, its shortcomings as the key currency are well known such as its high transaction costs, anti-growth bias of European economy and its fragile governance structure (Cohen, 2009, pp. 148–151). Even after the Lehman crisis, there is no sign that Euro's international use is growing in a substantial way. While EU successfully created the European Central Bank to administer the European monetary policy, its fiscal policies and financial supervision are still national. Also European continental financial markets cannot match the dollar-based market in New York in its depth and efficiency. On the other hand, at this juncture of history, development of the RMB is merely a remote possibility in the future as the Chinese currency is not even fully convertible and its financial market is still tightly regulated. Besides, even if there is a viable alternative, monetary arrangement must be highly path dependent. Once the dollar-based transaction is deeply institutionalized in private capital markets, switching it into some other currency can be highly costly. Institutional inertia is likely to be very strong when it comes to money.

This, however, does not mean that there is no change at all in the dollar's status. Given the heavy reliance on stable capital inflows from abroad for its credibility, the position of the dollar is now more vulnerable than before, particularly after the credibility of the US financial market that kept attracting indispensable capital became highly questionable. The dollar can perform its key currency roles only when major global financial players keep using it for transactions and for storage of values. Thus, in order to defend the dollar's current position, the United States now needs to make more deliberate efforts to gain the trust of global economic players.

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The dollar in such a condition can be called a 'Negotiated Currency' after the typology of Susan Strange (Strange, 1971, pp. 17–36). A negotiated currency works as an international currency only with the support of other major economies that are using it as the main reserve currency. This concept is coined to capture the way sterling was managed and supported by the Commonwealth countries and British Western partners after WWII. Sterling had been a 'Top Currency', which was demanded by everybody regardless of political relations with the UK for unquestionable credibility and stability of its economy before WWI. But as its confidence was undermined after WWI, it became more of a 'Master Currency' whose international roles were increasingly dependent upon the British Imperial political tie. London had to resort to its political influence to have governments within its empire hold sterling for foreign exchange reserves and to pool dollar and gold balance within the empire. After WWII, when colonies became independent and Dominions became more attracted by the United States for both political and economic reasons, the UK government could no longer simply force unwanted sterling balances onto follower countries.

The UK government offered both positive and negative incentives to maintain sterling's key currency status. In the first place, it threatened those countries in the sterling zone that converting the sterling balance into gold or dollar would damage the very value of their sterling holdings. It also gave positive inducement to them by giving preferential access to its market for their exports and capital. For example, in the 1960s, when Australia, which held a large portion of overseas sterling balance, was diversifying its reserve, the UK had to give preferential access to its capital market. It also had to keep importing New Zealand butter and lamb (Strange, 1971, p. 85). In some cases, it even offered foreign aid to induce newly independent members of Common Wealth countries to have them hold its foreign exchange reserve in sterling. The UK even had to give military protection to Singapore and Malaysia to stop them from running down their sterling balance (Strange, 1971, pp. 96–97). In addition to these, the UK after it devalued the sterling in 1967 had to guarantee the dollar value of a part of official sterling held by countries in the overseas sterling area. This arrangement was a quid pro quo for credits given by G10 under the Basel Agreement. 'In return, the UK offered a guarantee of the dollar value of 90% of each of these countries' official sterling reserves so long as the minimum sterling

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proportions were met. Countries could break the agreement and diversify, but they would lose the USD exchange guarantee. The goal was to limit the diversification away from sterling through these agreements, with a guarantee underpinned by the $2b safety-net if global reserves as a whole fell sharply' (Schenk, 2009, p. 21).

The dollar, on the other hand, was the 'Top Currency' in the 1950s. The dollar was readily accepted even within communist countries as well as in black markets all over the world. Since the 1960s as the United States' current deficits became more salient, there was more multilateral consultation among major economies to sustain the dollar's par value by stopping the gold drain from the United States. Thus, there were more elements of negotiation in the status of the dollar then. In the 1970s, after the collapse of the Bretton Woods system, many envisaged a more multilateral system where the dollar's role was less predominant.

The Committee of Twenty, which was set up in 1972 to work out a plan for new international monetary system replacing the Bretton Woods system, for example, recommended in its final report submitted in 1974 a reform whose main features are 'an effective and symmetrical adjustment process, including better functioning of exchange rate mechanism, with the exchange rate regime based on stable but adjustable par values and with floating rates recognized as providing a useful technique in particular situations'. It also called for reduction of roles of gold and the dollar as reserve asset. Instead, it envisaged SDR to be the principal reserve asset (Committee of Twenty, 1974, p. 8).

The report of C20, however, was shelved and completely forgotten. Major economies adopted floating exchange rates with the dollar containing to be the predominant international currency. But one can say as the dollar keeps depreciating, it became closer to a 'Negotiated Currency' whose value had to be propped up by cooperation of major economies. Particularly, after the Plaza Accord in 1985, financial markets became highly sensitive to every single move of Japanese institutional investors, which kept pumping their investment money into the depreciating dollar. The dollar's exchange rates became constant agenda among G7 countries (Funabashi, 1988).

Since the mid-1990s, however, because of robust American growth and the central roles played by the US financial markets in rapidly growing global financial intermediation, the world has witnessed the United States as the hyper-power whose currency might have become the

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top currency again. After the start of the financial crisis in the United States in 2009, heavy US dependence on constant capital inflows and large foreign dollar holdings has again come to be perceived as a source of vulnerability. If foreign creditors start questioning confidence in the dollar and capital outflows starts from the United States, it will trigger collapse of the dollar followed by higher interest rates and inflation.

Will the United States also find itself in a position to resort to overt political pressure to induce foreign holdings of the dollar? Or will it need to start borrowing in foreign currencies or guarantee value of dollar balances held abroad? Depending on future performances of the US economy, they are all realistic possibility and the United States may need to spend more political capital in persuading creditors to prop up dollar. But historical comparison of the experiences of sterling in the 1960s and the dollar 50 years later suggests that the dollar is still in a much stronger position.

First and foremost, in the 1960s, there was a clear alternative to sterling, namely dollar and to a lesser extent gold. Although the dollar in the 1960s was not as stable as in the 1950s, still it represented clearly a lesser evil. At this juncture of history, Euro is the only potential competitor with the dollar. Yen which was once expected play more international roles in the 1980s has already dropped out of the competition and the RMB has not even been fully convertible enough no matter how impressive Chinese economic growth may appear.

Secondly, politically, while the British Empire had already been lost, the American political hegemony is still there. By the 1960s, for most of overseas sterling countries, the UK could no longer offer security umbrella nor indispensable market. For example, for Australia and New Zealand, no matter how strong their emotional ties with the UK might be, the experience of WWII amply proved that the UK would no longer be very reliable for their ultimate national security. It was obviously the United States that was critical and that is exactly why Australians fought in Korea and Vietnam side by side with Americans. For the export market, it was no longer the UK that was trying to join the European Economic Community (EEC) but the growing Japan that was becoming the largest market for their products. On the other hand, the United States is still the final guarantor of Japan or arguably the East Asian region as a whole and its role as the global security player is obviously unrivaled.

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Thus, with no attractive alternative readily available, major economies in the world have strong economic incentives to maintain the existing dollar-centered hegemonic monetary system. Some may be forced to cooperate with the United States for political reasons in by maintaining official dollar balances and by encouraging private actors to invest into the dollar assets. But the United States is now less free in acting unilaterally. It must be engaged in negotiation and sometimes offer carrots or wield sticks to secure cooperation from other players.

5 Limits of the dollar

Despite the preceding discussion, dollar's dominance is neither limitless nor unconditional. It is conceivable to see the end of the hegemonic dollar in several ways. One possible way is a collapse of the dollar by financial mismanagement by the United States and its intentional abandonment of the key currency roles. If the US government should mismanage its economy and finance, the dollar could lose trust of the private market.

The weak point of the hegemonic monetary system is that there is no mechanism to check abusion of monetary privileges by the hegemon. In view of the level of financial globalization, the abusion, however, may be punished by global financial markets rather than other state authorities. It is possible that monetary authorities may lose control over the situations once American authority loses credibility. In the 1960s, when private international financial flows were still far limited than today, major countries could manage to defend sterling by holding official sterling balances. Even in the late 1980s, they could prop up the dollar by intervening into foreign currency markets and manipulating interest rates as well as talking up or down currencies. But today, given the enormity of private financial transactions and newly developed financial instruments, it has become obviously far more difficult for monetary authorities to control the global financial market. In such condition, one cannot rule out the possibility that the dollar loses trust of the market.

Second possibility is failed political negotiation among major players. The hegemonic roles of the dollar have now become more dependent upon negotiation among major economies. If they cannot agree how to share costs to prop up the hegemonic dollar, it will be exposed to the pressure of market forces. Major financial players today are far less

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homogeneous than before the 1980s, with Chinese, Russian, and Arabian oil producers as major parties of multilateral negotiations. In contrast, in the case of sterling, it was the Empire that politically bound the group together. In the case of the dollar in the 1980s, it was Western allies particularly West Germany and Japan, two most obedient allies of the United States, that implicitly subsidized American political roles by accepting rapidly depreciating dollar. It is obvious that Chinese and Russian do not have similar political attitudes toward the United States. Thus, multilateral negotiation to manage the dollar can be much more complicated.

Of course, nobody wants a major financial crisis. It must be noted that even China whose national economy is critically dependent on exports to the US market and whose foreign currency reserves are largely held in the form of the dollar have strong stakes in soundness of US economy. Thus, while Chinese are voicing their desire for super-sovereign currency, they have strong incentives not to rock the boat. On the other hand, the United States whose dissatisfaction with undervaluation of the RMB is well known, and is in a position to ask the Chinese to keep financing their enormous current deficits by buying American Treasury Bonds. Thus, the relationship between the two largest players in the world economy is highly symbiotic or a financial version of 'mutual assured destruction'.

And yet, financial brinkmanship may continue and dangerous 'escalation' may take place. For example, Chinese authority may overdo their bluffing whereas the US Congress might mess up the delicate relationship by launching trade wars with China. Even if two states could somehow refrain from destructive escalation, their confrontation might be enough to frighten global financial market triggering major disruption.

Thirdly, a gradual but constant relative decline of the US economy would encourage a shift away from dollar assets. The cumulative effects of small shifts may at some day hit the tipping point and can create a nonlinear major transformation of the whole system. While larger economies can be relatively easily persuaded into joint support of the dollar through negotiation, smaller economies may perceive their moves are too small to cause a systemic impact. They may be tempted to free ride on joint efforts by major economies to maintain the dollar-based system. France, for example, converted their dollar holdings into gold in the 1960s without causing a crisis in the 1960s. There will be nothing strange

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in smaller economies around rapidly emerging economies such as China and India being tempted to switch their dollar holdings into Rupee or RMB. If and when the RMB or Rupee zones become large enough, major capital flights away from the US economy and dollar assets would be a realistic possibility.

While it is likely that dollar continues to play predominant roles in international monetary system with cooperation of major economies, after the above-mentioned challenge to the dollar even happens, what sorts of international monetary system could possibly emerge? The system characterized by a single super-sovereign currency is the least likely scenario. As was mentioned, currency union at the end of the day requires a high level of political integration. If the pattern of distribution of world economic power continues to shift away from the 'West', the world would become even more heterogeneous where the demanding solidarist project would materialize. While some artificial units of account like SDR might be more widely used and other man-made reserve asset like Bancor may well expand their roles, it is difficult to imagine that these could be more trusted than national currencies issued by national governments that ultimately guarantee the value of them.

More pluralistic monetary order is more likely than the super-sovereign currency scenario. This very much depends on future distribution of economic resources among major economies. Currently, it is widely assumed that growth of emerging economies particularly China and India will continue to outpace that of the US economy. Judging from unreliability of long-term prediction of economic growth in the past, it is far from certain if the projection comes true this time. In addition, past experiences of DM and the yen suggests, more than a large economic size and stable exchange rates are needed to be an issuing country of an international currency. Besides, as was pointed out, there is natural tendency for market participants to select a single currency because of network externality. Still, if the United States get too complacent in the privilege, we might see a more pluralistic world where the declining superpower continuing issuing the key currency which is increasingly challenged by a few of rising currencies. This may somewhat resembles the world pre-1914 where the sterling continued to be key currency while a few national currencies such as the US dollar, French franc, and German mark started challenging the UK hegemony (de Cecco, 2009). The system was far from stable as there were occasional

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scrambles away from sterling for gold. But the world lived with instability. Likewise, although a more oligopolistic international monetary may not be terribly attractive, there may be no use deploring inevitability. Alternatively, for a more stable financial environment, we might see a more compartmentalized world with monetary zones more self-sufficient financially and commercially whereas monetary relation between different zones being more tightly controlled. This compartmentalized world into several economic zones, however, might mean a serious reversal of globalization.

Another possibility for the world after dollar is wider use of private money where means of transactions provided by private entities are more trusted than national currencies. Although we are so used to a territorial national currency, it is only nineteenth century that national territorial currencies became dominant form of money. Before that period, foreign currencies were widely circulated alongside domestically issued currencies despite efforts of many rulers to prevent the practice (Helleiner, 2003, pp. 21–22). An interesting example is Maria Theresa's Thaler (MTT), a silver coin originally minted since 1741 by Hapsburg mints. 'By the mid-19th century the MTT had come to circulate from the northwest coast of Africa to Madagascar and from the Turkish coast of the Black Sea to Muscat. In time the MTT came to be legal tender in many countries well into the 20th century. In particular, it survived as legal tender in Saudi Arabia (until 1928), Ethiopia (until 1945), Yemen (until 1962), and Muscat and Oman (until 1970) (Tschoegl, 2001, p. 443). Even in Japan which had relatively closed economy, it is widely known that between twelfth and sixteenth century a great deal of coins minted Sung China were circulated long after the very dynasty collapsed in thirteenth century. In addition, imitations of the Sung coins minted privately were also widely circulating alongside the authentic coins (Kuroda, 1999). In both cases, what was underpinning the confidence and acceptability of the money was obviously not the state power but market practices.

Privately provided electronic money for commuter trains and buses are no longer anything novel in many parts of the world. In addition, many attempts to issue private local currencies have been made all over the world to revive local communities. There is even a call for a global reference currency (Lietaer, 1999). Because of technological progress made in computers and telecommunication, managing and administering

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money has become much cheaper than in the past. If the dollar collapses in an abrupt and nonlinear manner with no attractive official alternatives available, the world after dollar is the world where private moneys could overwhelm national currencies.

6 Conclusion

The privileged status of the dollar has been intricately related to American political roles. At first, the dollar was crowned under the Bretton Woods agreement by unquestionable American economic might and political hegemony. Later, however, it was the dollar's status that facilitated financing and subsidizing American hegemony by allowing the United States to live beyond its means, to gain seigniorage and effectively writing off its external liability through devaluation.

Since there is no way to impose discipline on American behavior under this arrangement, it is of no surprise that the United States abused the privileged status of its national currency. '(T)here is a principle-agent problem at the core of the international monetary system. In case of conflict, the Fed could be trusted to follow the course that would, in its perception and in accordance with domestic statute, benefit the United States, even if this would be against the interests of all the other users of the international monetary system' (Steil and Hinds, 2009, p. 201). To put it another way, accepting the centrality of the dollar implies acknowledgement of the US 'imperial' roles. Thus, it is natural even for American allies to attempt to reform the system to make it more symmetrical by uncrowning the dollar so that the United States should not continue abusing this privilege.

Nevertheless, the dollar's position is likely to be sustained in the near future, for several reasons. First and foremost, there simply is no alternative to the dollar. Secondly, major creditors are trapped in the dollar system as they cannot challenge the system without damaging their interests, and thus have high stakes in sustaining the dollar. Thirdly, for monetary affairs, network externality is at work, thus it is difficult to have pluralistic currency arrangements. There is also institutional inertia involved into the whole system.

But the current privileged status of the dollar is neither unconditional nor limitless. As it is difficult to imagine that the rest of the world, particularly Chinese, Russians and Arab oil producers, is prepared to

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finance American deficits indefinitely. In order to sustain the dollar's roles, more negotiations among major economies will be needed to manage the American national economy and currency. It is like preventing a revolution against the dollar by transforming it into a constitutional monarch. Although the likelihood of a revolution is limited at this stage of history, the position is more vulnerable than before. Thus, market may find dollar not trust worthy should the United States fail to manage its economy and finance properly. Or, should negotiation for supporting the dollar fail among major countries, the dollar could be forced to give up its throne.

Both the probability of the end of the dollar and the shape of the world after the dollar depend on structural variables such as distribution of economic powers and geopolitical conditions in the world as well as evolution of private financial market. But, at the same time, it will also depend on policy preferences and strategic choices of relevant states involved in international negotiations particularly the United States, by far the largest debtor in the world and the issuing country of the dollar and China, the largest official dollar holder and strategic competitor of the United States and Japan, though often forgotten, the largest creditor in the world and obedient subjective US ally so far with increasing economic ties with the fast growing neighbor.

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