A SYMPOSIUM OF VIEWS

Is the World's Reserve Currency In Trouble?

To what extent will the global role of the U.S. dollar have changed a decade from now?

True, America's deep and highly liquid financial markets, investment-quality dollar-denominated assets, and the rule of law make the dollar the preferred global currency for commerce and trade. There is no obvious contender.

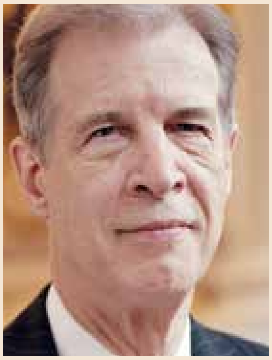
But the dollar and the U.S. banking system have become major tools of U.S. foreign policy at a time of deep and growing geopolitical rifts.

Increasing efforts by other economies and organizations to circumvent U.S. dollar domination include the new Chinese digital currency, Facebook's Libra, the decentralized Bitcoin, Europe's INSTEX system for avoiding secondary sanctions for trading with Iran, and even calls for a global digital currency from the Bank of England's Mark Carney and a digital euro from the association representing commercial banks in Germany.

The Chinese state-run digital currency, for example, is highly unlikely to replace the dollar, but could it have the effect over time of trimming back the dollar's use, particularly in the developing world economies? Moreover, the crime syndicate-based segment of the global financial system, which today is said to exceed in size most developing-world GDPs, is likely to become more than familiar with the growing world of digitized artificial currencies.

How will the dollar, and thus America's financial flexibility, be affected by this coming brave new world of digital payments technology, if at all?

***TIE* asked more than two dozen distinguished thinkers.**



The dollar-based system remains effective but has lost much of its legitimacy.

WILLIAM H. OVERHOLT
Senior Research Fellow, Harvard Kennedy School, author,* China's Crisis of Success *(2018), and co-author,* Renminbi Rising: A New Global Monetary System Emerges *(2016)

The U.S. dollar's hegemonic position has been sustained by open financial markets, deep liquidity, the reliability of the U.S. Federal Reserve and Treasury, and a workable global consensus that the dollar system provided vital public goods. Its greatest strength is the weaknesses of its competitors. The euro is not a deep pool of liquidity but rather a collection of puddles. The Chinese RMB market is fragmented into multiple bond markets with different regulators and no coherent yield curve. When Chinese financial markets were steadily opening, through about 2015, international use of the RMB rose at spectacular rates, but recently capital controls have tightened and those trends have slowed or reversed. Blockchain alternatives remain primitive and untested.

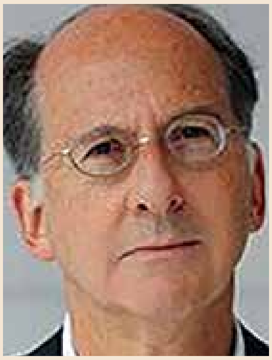
In the future, the euro market could become more integrated and the European Central Bank could well acquire a reputation for reliability comparable to that of the Fed. Chinese financial markets will probably become more integrated, and China could shift massively from bank-based finance to bond and equity finance, creating a very deep market. However, capital controls will persist until China's fraught domestic political environment and anti-corruption regime provide fewer incentives for capital flight.

While developments in the euro, RMB, and blockchain are gradual, the big change is in the international prestige of the dollar system. The Global Financial Crisis of 2008–2009 led some countries, most notably China and Russia, to advocate a system where they would be less vulnerable to dollar fluctuations.

Since the U.S. Congress imposed constraints on helping troubled countries after the Mexican crisis of 1994, and the United States failed to help Thailand and Indonesia in 1997–1998, the Fed and Treasury have lost some of their reputation for reliably providing crisis liquidity to friendly countries. Frequent use of sanctions to impose U.S. foreign policy on anyone who does dollar transactions has culminated with European allies scrambling to find a non-dollar way to transact with Iran after the U.S. abandoned a hard-won collective non-proliferation deal with Iran. There have been moments of mass use of the Hong Kong dollar as a proxy for the U.S. dollar that does not entail vulnerability to U.S. sanctions.

After Trump's full or partial abandonment of the Iran deal, the Paris climate deal, traditional support for democracy, traditional open internationalism, and traditional support of allies, the strong association of the dollar with benevolent U.S. policies and vital public goods has greatly weakened.

In political science jargon, the dollar-based system remains effective but has lost much of its legitimacy. Many countries will continue to chip away at their reliance on dollar reserves and dollar-based transactions to whatever degree attractive alternatives emerge. Those changes will be incremental and could experience reverses. That trend will contract the dollar system at the margin but maintain its dominance. If some drastic global financial development changes the relative attractiveness of U.S. openness and liquidity, much of the world will abandon the dollar system with alacrity.



China is still more pretender than contender.

MARK SOBEL
U.S. Chair, Official Monetary and Financial Institutions Forum, and former Deputy Assistant Secretary for International Monetary and Financial Policy, U.S. Treasury

The dollar was not ordained as the world's reserve and financial currency or declared so by fiat. It happened in response to organic factors—a large vibrant economy, deep liquid capital markets, and strong property rights.

These characteristics will not be replicated elsewhere in the coming decade. The U.S. economy will outperform advanced economies. The euro area and Japan are anemic, the former beset by weak banks, over-reliance on the ECB, and an imperfect union. Britain is racked by Brexit. Australian and Canadian markets are too small.

China is still more pretender than contender. Yes, China has a massive, growing economy and its amazing transformation continues. But it also has an increasingly authoritarian government, huge amounts of non-performing loans, excessive leverage, an inconvertible currency, capital controls, opacity, and capricious respect for property rights.

Global network effects reinforce the U.S. financial system's clout, and inertia further backs the status quo.

There is much talk about China leading on central bank digital currencies; Mark Carney speaks about synthetic hegemonic currencies; Facebook touts Libra. Expunging RMB cash from the Chinese retail system with a CBDC won't change China's financial realities. A synthetic hegemonic currency will prove as attractive as the Special Drawing Rights. Libra faces humongous hurdles getting off the ground.

America shouldn't be complacent—while the dollar's role may only ebb in the coming decade, tipping points can be reached.

U.S. abuse of financial sanctions looms as a potential future challenge to dollar dominance.

Financial sanctions can be a powerful tool. They should be used prudently. As evident in the George W. Bush and Obama administrations, financial sanctions, supported by our allies and/or multilateral institutions, can help achieve broadly shared global aims. That is the case with UN financial sanctions on North Korea. It was also true of Iran on the Joint Comprehensive Plan of Action. Such multilateralization is unlikely to have a detrimental impact on the dollar's global role.

In contrast, the current administration has overly used unilateral financial sanctions. When not backed by our European allies and/or internationally, unilateral sanctions may have a corrosive impact on the dollar's future. It is remarkable that our European allies, angered by U.S. actions over Iran, are now seeking—even if ineffectively—to develop alternative payments systems that bypass the dollar.

America benefits from the dollar's global role—seignorage, lower borrowing costs, and less exchange risk. But that role is not without downsides. The United States runs current account deficits with implications for jobs and growth at home.

Rather than fixating on whether the dollar's global role will change over the next decade, let's refocus on soundly and wisely running the U.S. economy and financial system and returning America to the path of multilateralism.

The key question: Would the world economy benefit from change in the dollar's status?

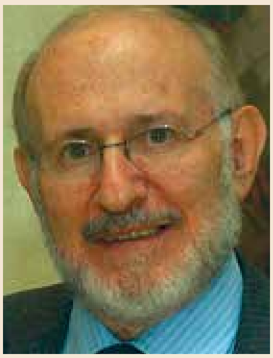
ALEJANDRO DÍAZ DE LEÓN
Governor, Bank of Mexico

For decades, the U.S. dollar has been the prime currency in international trade and financial transactions, performing the functions of medium of exchange, store of value, and unit of account worldwide. Its dominant role has been underpinned by the U.S. role in the global economy in terms of trade and financial flows, the size of its economy, its rule of law, and its deep and liquid financial markets. In addition, network externalities imply that the more the U.S. dollar is used in financial and trade transactions, the more liquid it becomes and further enhances its benefits relative to other global currency alternatives.

The status of the U.S. dollar as the dominant global currency is a recurring theme in the international financial arena. Back in 1999, the emergence of the euro was expected to increase competition to the dollar in trade and financial transactions and as a reserve currency. Also, some believed that the 2008–2009 global financial crisis could curb the dollar's status. Contrary to those views, the dollar has consolidated its dominance in global financial markets. According to the Bank for International Settlements, the global foreign exchange market's daily turnover reached US$6.6 trillion in April 2019, with the U.S. dollar on one side of 88 percent of all trades. Moreover, according to the International Monetary Fund, between 2008 and mid-2019, the share of worldwide reserves that central banks held in dollars remained roughly constant, representing 62 percent of the total, while reserves in euros dropped seven percentage points and now account for 20 percent of global reserves.

More recently, the arrival and rising interest in digital currencies has once again drawn attention in regard to the dollar's long-lasting leading position. Digital currencies are perceived by some as an opportunity to limit the dollar's global dominance. Nonetheless, there are very clear differences among potential digital currencies. The most radical private versions are unlikely to constitute a true medium of exchange, store of value, and unit of account for the global economy. Moreover, they can become a source of financial systemic risk and a menace for ill-informed consumers. This has led central banks to evaluate and consider the need for developing and issuing some version of public digital currencies. Some have even called for the creation of a "synthetic hegemonic currency" provided by a non-private agent, perhaps through a network of central bank digital currencies.

The key question is if changing the current U.S. dollar-based system will eventually be beneficial for the world economy. This hinges on whether the current system is adapted to incorporate new technological developments—digital and more efficient cross-border payments solutions—and if it is used in a fair and transparent manner. If these challenges are adequately addressed, the dollar-based system could retain its predominant role. If this is not the case and the current system is used to pursue other foreign policy objectives, this could endogenously accelerate the search for alternative currencies and digital solutions that may undermine the current role of the U.S. dollar.



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The dominance of the U.S. dollar could strengthen.

The current debate on the changing global role of the U.S. dollar can be related to two distinct developments. The first is the rising economic power and influence of emerging markets together with the robustness of the euro as a relatively stable new currency block. This trend would lead to the analysis of the international role of the dollar within the context of traditional portfolio analysis of reserve currencies, that is, the strength and credibility of the dollar and dollar-denominated assets relative to other existing and growing currencies/assets.

The second development is a completely new phenomenon: the potential currency competition arising from rapid digital currency innovation. This considers the challenge to the dollar (and to any other actual or potential reserve currency) from digital currencies from both the private and the non-U.S. public sector (and their combination).

We argue that these two developments, although distinct, are in fact connected; and their combined impact on the dollar's global role could be neutral—or even strengthen the dominance of the U.S. dollar in the coming decade.

Our starting point is that any viable currency needs to be backed by a strong balance sheet. Until now this balance sheet has been typically that of a sovereign, that is, the public sector balance sheet of the currency-issuing country. The strength of the U.S. economy, together with its deep and liquid markets and rule-based legal framework, have given rise to high demand for U.S. dollar-dominated assets in the post-Bretton Woods world, and the United States has willingly provided this liquidity to the rest of the world through its large current account deficits (effectively paying for its net imported goods with paper dollars).

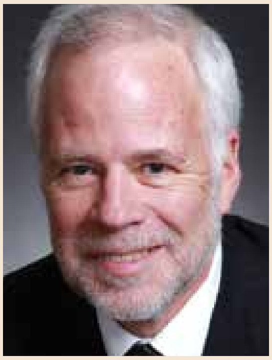
How do the two developments mentioned above affect the situation?

The past decade has seen a shift in the center of economic and political gravity away from the West, including the United States, toward emerging market economies. China is now the world's second or already the largest economy. Meanwhile, advanced Europe has been experimenting with a single currency bloc, the eurozone, for the past two decades.

But the balance sheets of these underwriting sovereigns (China and the eurozone) are subject to serious, albeit very different, pressures, and until those are credibly removed, the renminbi and euro will not pose real threats to the dominant role of the dollar. The renminbi is the currency of an economy close to the "middle income trap": for maintaining high economic growth, China needs innovation and a risk-based financial system that allocates resources efficiently. Both are hard to achieve at scale under the current state-managed economy. On the other hand, the eurozone is struggling with well-known design flaws that are faced only during crises, which come at a high political price to European unity with the consequent erosion of credibility.

Digital currencies challenge all traditional fiat currencies. However, their big problem is long-term viability—the strength of the underlying balance sheet on which the currency can fall back on in case of stress or crisis. This lack of underlying strong balance sheet is a main reason for the volatility of first-generation private currencies such as Bitcoin. Second-generation private digital currencies address this problem with the creation of so-called stablecoins, which are digital currencies pegged to fiat currencies or to a pool of assets and/or commodities. This has been an important innovation that can reduce volatility and increase the credibility of private digital currencies. Yet it ultimately leads back to sovereign balance sheets: directly in the case of pegs to fiat currency, and indirectly for asset-backed stablecoins through economic and financial cycles. (The link to sovereign balance sheets is obvious for public sector/central bank digital currencies.) In this context, one should expect that credible and long-lasting digital currencies will be linked, directly or indirectly, to the most desired reserve currency, which, as we argue, will remain the U.S. dollar in the foreseeable future.

It is clear that the dominance of the U.S. dollar as reserve currency is therefore very likely to stay, both on account of traditional portfolio considerations and also as the most relevant peg for digital currencies. In fact, it would probably strengthen through the growth of the more viable pegged digital currencies, the stablecoins.



For alternatives to the dollar, look toward Brussels and Berlin, not to Beijing and Shanghai.

BARRY EICHENGREEN
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There is a consensus answer to this question. The dollar overwhelmingly dominates international payments and international finance generally. The only conceivable contenders, the euro and the renminbi, lag far behind. Hypothetical alternatives such as Facebook's Libra and Carney's synthetic hegemonic currency are unlikely to get off the ground. Hence, nothing will change for the foreseeable future.

The theoretical arguments buttressing this conventional wisdom are strong. The historical evidence, not so much. History shows that the identity of the leading international currency can change quickly, as it did between 1914 and 1924, when the dollar overtook sterling as the leading currency used in international transactions. As Arnaud Mehl, Livia Chitu, and I show in our book, *How Global Currencies Work* (2018), two shocks conspired to bring about this shift. First, there was a significant institutional change enhancing the appeal of the challenger. In this earlier historical episode, that change was the advent of the Federal Reserve. Second, there was a major shock undermining the strength and appeal of the incumbent. In this earlier episode, that shock was World War I.

What would be the equivalent now? First, the creation of Eurobonds. This would be a significant step in the direction of a deep and liquid market in safe euro-denominated assets. And liquidity makes all the difference for importers, exporters, and investors when choosing a vehicle for international transactions.

Second, additional efforts on the part of a U.S. administration to weaponize the dollar. Threatening European governments and corporations doing business with Iran with loss of access to dollar credit was enough to prompt the creation of INSTEX but not enough for widespread abandonment of the dollar. U.S. President Donald Trump unleashed (in other words, a second term), if it led to more such measures, could cause Europe to get serious. Getting serious, in my view, would involve not the further development of INSTEX, which is only in the business of barter, but seriously contemplating Eurobonds.

The preceding implies that the challenge to the dollar will come from Europe, not China. Indeed that is my view. China has a long way to go in terms of developing deep and liquid financial markets, an open capital account, and rule of law. Observers contemplating alternatives to the dollar would do well to look toward Brussels and Berlin, not to Beijing and Shanghai.

The proliferation of technologies threatens the long-held U.S. monopoly of financial infrastructure.

JILL CARLSON
Investor in early stage companies, Slow Ventures, and Co-founder, Open Money Initiative

For three-quarters of a century, the United States has enjoyed dominance within the global financial system. This is often talked about as U.S. dollar hegemony. This phrase, however, fails to capture just the extent of the United States' financial influence. The dollar is not the only factor that affords the United States special power: U.S.-controlled infrastructure and

U.S.-driven legal and regulatory paradigms are equally, if not more, important.

The U.S. dollar is an asset that can be stored, transferred, and traded in many mediums: physical cash, the SWIFT network, Venmo. In speaking of any currency, one must also consider the infrastructure being used. In order to examine the current state of the financial system and in order to understand what the future might look like, it is important first to disambiguate assets from their infrastructure or mediums.

WeChat renminbi. INSTEX euros. British pound coins. Bitcoins on a blockchain. Each of these has different properties based not only on the denomination but also on the format of the currency. Largely, WeChat renminbi are only available for use by Chinese nationals, whereas anyone can hold physical yuan. INSTEX euros can be used in transactions with Iran while any attempts to transfer euros to the country using the SWIFT network are sanctioned. British pounds held in PayPal are immediately and easily divisible into pence, while the divisibility of a pound coin depends on the availability of change from another party. Bitcoins held directly on a blockchain can be used by anyone with an internet connection, while bitcoins held on an exchange can only be used by those who have passed its know-your-customer compliance procedures. In examining not only assets but also their mediums, a more nuanced picture of the global political economy emerges.

The use of the dollar in pricing commodities, pricing debt, and indeed pricing and pegging other global currencies has long been under siege—and long prevailed. The renminbi's addition to the Special Drawing Rights basket was heralded as a turning point. The Chinese market itself has welcomed the issuance of SDR-denominated bond offerings. Efforts like these are clear attacks on the singular dominance of the U.S. dollar.

As important, however, have been the shots fired at the singular dominance of U.S.-controlled infrastructure. The aforementioned INSTEX, Europe's answer to SWIFT in the face of enforcement of sanctions on Iran, is one such example of this. Venezuela's efforts to evade sanctions and tap capital markets through the issuance of the petro, a digital asset, is another such effort. Russia's bilateral currency swap agreements are yet a third. Here, on the infrastructure side, countries have found some success in asserting their sovereignty in the face of historical U.S. supremacy.

The emergence of digital payments technology is not *ipso facto* an assault on the U.S. dollar. The global proliferation of these technologies, however, does represent a threat to the United States' long-held monopoly of financial infrastructure. As infrastructure leads, the assets often follow. Should the new systems that are emerging today, from Alipay to Zcash, continue to gain relevance, the erosion of the U.S. dollar's power would make for an unsurprising second-order outcome.

Sales of dollar assets by non-U.S. financial institutions could lead to fire-sale prices. Sales of domestic assets to raise dollars would further strengthen the dollar. Either could significantly worsen a crisis.

WILLIAM R. WHITE

Former Economic Adviser, Bank for International Settlements

In real life, what should happen often differs sharply from what does happen. The current international financial non-system, centered around the use of the U.S. dollar, was not constructed but simply evolved out of the wreckage of Bretton Woods. Its many shortcomings imply that it should be replaced.

It has no adequate mechanisms for reducing current account imbalances. It allows disruptive spillovers of U.S. monetary policy to an ever-growing economic periphery. It is dangerously unanchored. It has no unquestioned lender of last resort. Finally, it allows the U.S. government to use the U.S. dollar as a geopolitical weapon. In short, this non-system does not act in the interests of all and is increasingly prone to crisis.

Indeed, another global crisis seems likely. "Currency wars" between central banks have encouraged easy money and unprecedented debt accumulation, not least in emerging markets. Financial stability is threatened by squeezed margins at financial institutions and the search for yield. Many asset prices seem unreasonably high, and corrections could be disorderly. Finally, monetary and fiscal policies are "trapped" by plausible arguments against both easing and tightening.

A small silver lining is that such a crisis might prompt a coordinated global attempt to redesign the international financial system. Unfortunately, even this is not likely to happen. The existence of a link between crises and systemic shortcomings is not universally accepted. Moreover, even if the need for reform were agreed, alternative proposals would surface. Finally, agreements at the level of theory still need active cooperation to implement. Given the growing distrust of national governments, and of globalization, that seems highly unlikely.

Absent a cooperative agreement to fashion a new system, events on the ground will determine subsequent developments. As before, the system will evolve in response to shocks. Today, one particular shock seems likely. Similar to the last "trans-Atlantic" crisis, the next one will also reveal that many non-U.S. financial institutions face a massive shortfall in short-term dollar funding. Sales of dollar assets could quickly lead to fire-sale prices. Sales of domestic assets to raise dollars would further strengthen a dollar already benefiting from "safe haven" status. Either outcome could significantly worsen the crisis.

In 2009, dollar loans from the Fed to foreign banks in the United States, and through swap agreements with foreign central banks, were crucial. As well, the G20 agreed to increase the allocation of Special Drawing Rights at the International Monetary Fund by $250 billion. There are various grounds for belief that the Fed might be less able or willing to respond similarly in the next crisis. This raises the tantalizing possibility that the role played by SDRs and the IMF, as a lender of last resort in crises, might have to increase substantially. If this happened, attention might eventually be drawn to those other shortcomings of the dollar-based system that make such crises more likely. In this fashion, what should happen would happen, but it might take many years.

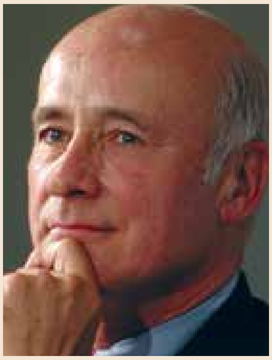
The U.S. dollar is on one side of 88 percent of all trades—just as it was fifteen years ago.

RICHARD JERRAM
Chief Economist, Top Down Macro

Over the years we have heard of various challengers to the dominance of the U.S. dollar, from the Japanese yen in the 1980s, the euro in the late 1990s, and more recently, the renminbi. However, the latest BIS Triennial Survey shows that the U.S. dollar is on one side of 88 percent of all trades—just as it was fifteen years ago.

It would require a huge shock to make much of a dent in such supremacy. At the moment, the only conceivable risk seems to be an unconstrained U.S. president (perhaps Trump in a second term) imposing some form of capital controls in an attempt to attack a perceived overvaluation of the exchange rate. This seems far-fetched and self-defeating, but we have learned not to dismiss such challenges to the orthodoxy. Even then, the U.S. dollar would probably remain dominant, but via creation of separate onshore and offshore markets, with commensurate fractures in the global financial system.

This leads to the question of whether digital currencies might drive the U.S. dollar (and other national currencies) towards obsolescence. This looks unlikely and probably unnecessary too, as many of the purported benefits can be obtained by digitization of existing currencies. Perhaps digitization will erode the extraordinary fees (or spreads) charged to retail customers by financial institutions for basic foreign exchange transactions, which have proved surprisingly enduring in a world of pricing pressure on most financial services. However, it seems unlikely to end the dominance of the U.S. dollar.



A wrecking-ball approach will reduce American power and the role of the dollar.

JOSEPH S. NYE, JR.
University Distinguished Service Professor, Emeritus, Harvard University, former U.S. Assistant Secretary of Defense, and author,* Do Morals Matter? Presidents and Foreign Policy from FDR to Trump *(Oxford, 2020)

Predicting the role of the dollar a decade from now depends on economic and technological change, but will also depend on politics. America has used the dollar as a weapon for a long time, particularly since 9/ll, but Donald Trump has taken it to a new level. Sanctions, tariffs, and restriction of access to dollars have been major instruments of his foreign policy, unconstrained by allies, institutions, or rules. As *The Economist* has said, America derives its clout not just from troops and aircraft carriers, but from being the central node in the network that underpins globalization. This mesh of firms, ideas, and standards reflects and magnifies American power, but our current politics are eroding it.

Trump is not the first president to manipulate economic interdependence, nor is the United States the only country to do so. In 1977, Robert Keohane and I published *Power and Interdependence,* a book that explored the variety of ways asymmetrical economic interdependence can be manipulated as a source of power. But we also pointed out that short-term gains sometimes turn into long-term losses. In 2016, Jack Lew, an Obama administration official, warned that it is a mistake to think that sanctions are low-cost. By one count, the Trump administration now has thirty active financial and trade sanction programs. Europe is exploring a cumbersome INSTEX system to avoid American secondary sanctions, and China is exploring digital currency. Such efforts will not displace the dollar, but will chip away at its role.

Of the foreign reserves held by the world's governments, just a few percent are in yuan, compared with 64 percent for the dollar. China is a rising power that wants a larger role for the yuan, but a credible reserve currency depends on currency convertibility, deep capital markets, honest government, and the rule of law—all lacking in China and not quickly developed. Ironically, these features of the American system proved crucial in times of crisis as we saw in 2008. While China could divest its large holdings of dollars, such action would risk damaging its own economy as much as the United States, and the yuan is unlikely to displace the dollar any time soon.

But the current system depends on confidence and trust. In my most recent book, *Do Morals Matter? Presidents and Foreign Policy from FDR to Trump,* I argue that capricious actions and disdain for norms and institutions are eating into that trust and increasing the incentives to chip away at the dollar's role. The Trump administration argues that willingness to break rules and institutions will produce major gains for the United States, but the relationship of power and interdependence changes over time, and too much manipulation can prove self-defeating. Using a wrecking-ball approach will reduce American power and the role of the dollar over the decade. How much will depend on how long the current approach persists.

America is not a global leader because of the dollar but because of its innovation.

ERIN ENGLISH
Global Policy Fellow, Visa Institute of Economic Empowerment

Rapid advances in innovative technologies—particularly in financial services—enable productivity and present new opportunities for governments and their citizens to collectively drive economic growth and execute new ideas. Digital transformation presents national governments new opportunities to execute economic policy in a manner that has the potential to erode the norms of the post-Bretton Woods era. It is important to acknowledge that these norms still serve a valuable role in the operation of the global financial system, including protecting the U.S. financial system from financial crime.

The United States financial system is comprised of multiple ecosystems: the capital market, the repo market, large value payment systems, and retail payment systems, each with its own infrastructures. These ecosystems vary in their exposure to international markets, competition, and risk. Some of these ecosystems are insulated from foreign competition. For instance, U.S. capital markets are likely to maintain their status as the place the world goes to raise money for the foreseeable future. The wholesale payment systems operated by the Federal Reserve System will continue to move vast quantities of money between large U.S. financial institutions. According to the Bank for International Settlements, 62 percent of the foreign currency local liabilities of banks are settled in dollars. Given this set of facts, although the dollar will face competition from the euro, pound, and yuan, there is no imminent danger of the dollar losing its reserve currency status.

But not all financial ecosystems benefit from the institutional, regulatory, and historical moats that protect the dollar, Wall Street, and the Federal Reserve. America does not owe its status as a global leader in consumer financial services to dollar dominance or Bretton Woods institutional arrangements, but rather to a series of developments that are a reflection of innovation. The global competitiveness of U.S. firms in segments such as retail innovation is a function in part of consumer demands. The United States was a first mover of payments, fintech, and hyperscale public cloud computing, all of which are a function of the ability of individual firms to create value for their customers. These firms operate in a highly competitive global market and must continuously innovate to remain competitive.

Understanding which elements of the U.S. financial system are exposed to competitive pressures, and which are protected by structural barriers, is a topic that national security leaders must understand.

The U.S. government has a critical responsibility to continue to protect the U.S. financial system from exploitation by terrorist financiers, drug cartels, and weapons of mass destruction proliferators. However, it is essential to remember that the U.S. financial system is not a monolithic whole but rather a number of self-sustaining ecosystems that compete globally. New technologies coupled with nationalistic sentiment, often driven by frustrations in sanctions policies, afford countries new opportunities to challenge that system. The international norms that have contributed to global economic comity for the past seventy years apply with equal force to the innovations in financial technology and new financial infrastructures that will shape the future. How the United States implements policy in protecting these norms will also have to innovate.

The opinions reflect the author's own, and do not necessarily reflect the opinions of Visa Inc.

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A decade from now, the global financial system will still run on dollars.

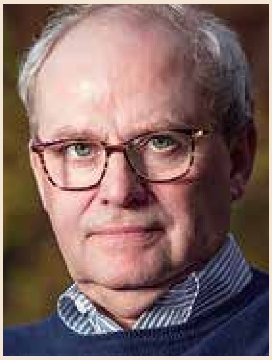
No one knows how the global financial system will evolve over the next decade, but we can look to the past as a guide to what the broad contours are likely to be.

First, the dollar-based system arose in the aftermath of World War I largely because of the trust established when the United States remained on the gold standard while others, especially the British, did not. Second, the pervasive use of the dollar today reflects sustained trust in the resilience of the American economic and financial system. Since the dollar became truly global a century ago, the United States has endured the Great Depression and the Great Financial Crisis, coming through those enormous disruptions healthier than other countries have.

A few numbers illustrate the extent of the point. Today, short-term dollar liabilities of banks outside the United States are roughly the same size as those inside the country—just short of $20 trillion. And the U.S. dollar is still one leg of nearly 90 percent of all foreign exchange transactions—that's $5.8 trillion per day. These facts highlight the continuing role of the U.S. dollar.

How might this change? First, technology is surely altering the delivery of financial services, and the way we make payments. But nearly all of what we call money is already a digital entry on the ledger of a financial institution. Second, while the use of finance and the predominance of the dollar as an American foreign policy tool poses risks, it is not a new phenomenon. Indeed, the rise of the Eurodollar market following World War II partly reflected fears that the U.S. government could seize foreign assets held in the United States.

We see two conditions necessary for a move away from the dollar. First, some other currency will have to be trusted. It is nearly impossible for us to see privately issued cryptocurrencies or tokens as having sufficient global trust. In fact, given that criminals are important users of some existing privately issued tokens, we wonder why governments have not cracked down: we surely would. Second, there will need to be a trigger that leads a large number of people to pay the cost to switch simultaneously. To be clear, the presence of very strong network externalities means that the change is unlikely to be piecemeal and gradual. All of this leads us to expect that a decade from now the global financial system will still run on dollars.



The greatest threat to the supremacy of the dollar is loose monetary policy.

ANDERS ÅSLUND
Senior Fellow, Atlantic Council

The U.S. dollar will dominate global transactions for the next half century, maintaining nearly two-thirds of all international currency reserves, while the euro accounts for one-quarter. It took half a century for the U.S. dollar to replace the British pound as the dominant currency, although the U.S. economy was so much larger.

In the end, the British pound dwindled in international transactions because the British government so desired. Its status of reserve currency left the pound overvalued, which caused an undesired current account deficit. Even so, the exchange rate of the pound fell steadily with the relative decline of the UK economy, not least because of comparatively high inflation.

A dominant global currency needs to be trustworthy, fully convertible, have a relatively stable exchange rate, have low inflation, and enjoy great liquidity. The greatest threat to the supremacy of the dollar is loose monetary policy leading to higher inflation than in competing currencies, which seems unlikely to happen any time soon.

Since the adoption of the Patriot Act in 2001, the U.S. Treasury has imposed stringent controls of not only the U.S. but the global banking system. Each dollar passes through one of the big-money banks in New York, giving the United States jurisdiction over all dollar flows. Some argue that this will deter many from using the dollar, but the evidence points in the opposite direction. U.S. anti-money laundering policies have excluded half of the world's countries from correspondent banking in U.S. dollars, and rather than developing alternative currencies, the many excluded countries do their utmost to gain U.S. approval.

Digital currencies offer no alternative. The bitcoin possesses none of the elementary qualities of a currency. It is no reliable store of value—if you lose your password, you have lost your bitcoins. It is not available if your computer system breaks down. It is highly speculative, offering no steady value. It lacks transparency and it is difficult to make transactions with bitcoins.

Financial systems are subject to government regulation, and the Libra is not likely to be allowed, as international financial regulation is not becoming looser any longer but is tightening up both in the United States and the European Union. Payments systems are subject to major innovations, reducing transaction costs, but that is likely to most of all benefit the strongest existing currency, the dollar.

The ultimate property of a dominant currency is its liquidity. The more churning that takes place, the more important are the transaction costs, and they depend on liquidity. Today, the churning is greatest in commodity trading, where a score of transactions is standard before a commodity is consumed. Therefore, commodities, such as oil and metals, are traded in dollars far more than other goods and services. Digitization and the facilitation of payments systems speed up transactions all the more, offering the dollar additional advantages.

Thus, the dollar's dominance is not threatened but might even increase.

The risk isn't a gradual decline in the dollar's role, but a tipping point in which alternatives quickly scale.

PETER HARRELL
Adjunct Senior Fellow, Center for a New American Security, and former Deputy Assistant Secretary for Counter Threat Finance and Sanctions, U.S. State Department

For more than two decades, various experts have predicted the end of dollar dominance. And throughout that time, the greenback remained the world's dominant currency. Yes, the dollar share of global reserves declined modestly. But the dollar remains dominant—and over the past two years central banks trying to diversify away from the dollar have bought gold at least as much as other fiat or digital currencies. In payments, the dollar has beaten back challenges from the euro and the yuan. While digital currencies are growing in popularity, price volatility and a murky regulatory outlook cloud viability.

Somewhat counterintuitively, the dollar largely sustained its dominance following the recession of 2008–2009. While the Great Recession started in the United States, a flight to safety meant that investors turned to dollars as the global outlook deteriorated. The United States compounded this advantage by responding earlier and more forcefully to the crisis than Europe, which continued to confront substantial uncertainty about the eurozone into 2013. From a strictly economic and fiscal perspective, the dollar should remain dominant over the mid-term as the United States outperforms Europe economically and China's reluctance to reform its capital controls and liberalize its currency slow the RMB's rise.

Yet despite the dollar's resilience, I do expect an erosion of dominance over the next decade, driven not by economics but by geopolitics. For a growing number of major powers, dollar dominance combined with Washington's weaponization of the currency is geopolitically untenable. Just as the United States would never allow Europe, Russia, or China to dictate our trading partners, Europe, Russia, and China are increasingly committed to finding mechanisms to ensure that the United States cannot dictate theirs.

U.S. adversaries have long sought alternatives to the dollar. But major powers, and particularly U.S. allies, had limited incentive to invest in the expensive and challenging process of establishing a viable, scalable alternative. That has shifted with a vengeance as not only adversaries but core U.S. allies in Europe begin to promote alternatives, particularly for payments, that reduce their dependence on the dollar as a payment for trade that never directly touches the United States. Technology can facilitate this process.

To be sure, start-up costs are high and timelines are uncertain in the quest to establish viable alternatives to the dollar. Russia's years-long effort to shift oil and gas pricing shows this, as does the RMB's slow internationalization. Global digital currencies, whether crypto national currencies or native cryptocurrencies, will take time to reach a scale that can handle transaction values not only in the thousands of dollars, but in the tens or hundreds of millions.

But once non-dollar payment channels are established, they have the potential to scale quickly. The risk isn't a gradual decline in the role of the dollar, but rather a tipping point in which alternatives quickly scale to a point where U.S. policymakers find their leading coercive economic weapon becomes far less potent than it was.

One standout contender is the digitalized renminbi.

JENNIFER ZHU SCOTT

Associate Fellow with dual fellowships of the Asia Pacific Programme and Digital Society Initiative, Royal Institute of International Affairs (Chatham House)

The U.S. dollar-centric global monetary system has had an extraordinary run for more than seven decades. Such systematic financial dominance has been translated into economic, trade, and foreign policies and helped the United States to assert itself as the superpower of the post-war world.

At the beginning of this journey, the U.S. dollar was pegged to gold. Today, the gold peg is long gone, but the United States shows no sign of giving up its global dominance. Behind the insistence of the U.S. dominance is the rapidly growing US$23 trillion national debt and multiple regulatory failures that eventually led to global financial crises. In front of it, a chaotic trade war and the current administration's frequent financial warfare waged against its geopolitical rivals and adversaries are motivating the world to seek alternatives and mitigate the rising U.S. risk.

But the alternative won't simply be another currency. The yen lacks ambition, the euro has its internal problems, and the renminbi hasn't been able to reconcile its internationalization ambition to domestic capital control. The shift away from the U.S. dollar-centric system is a collection of fragmented but undeniably effective actions that chip away the U.S. dollar dominance at an accelerating pace.

One standout contender is the digitalized renminbi of the People's Bank of China, China's central bank. The intention of China's digitalization of its currency is subject to interpretation. However, China is objectively ready and in need of such digitalization.

China is already the most cashless large economy in the world, thanks to the duopoly of mobile payment apps—WeChat, by Tencent, and Alibaba's Alipay. In 2017, the United States hosted a total of $337 billion in online payments. In China, it was a whopping $15.7 trillion, $3.2 trillion more than Visa and Mastercard's combined global volume. In 2018, China's online payment volume grew to $24 trillion. China and many emerging markets on the Belt and Road are more ready for fully digitalized payment systems than many developed markets.

Poverty eradication is President Xi's signature issue. With a digitalized sovereign currency, the central government would be able to send financial aid directly to each family, starting by distributing smartphones to them and avoiding the aid being siphoned off by layers of corrupt local officials. The digital sovereign currency would make international loans and aid more direct and traceable, too. When the recipient countries use the digital currency to pay for trade or infrastructure projects contracted by China, the net effect is that the U.S. dollar would be replaced in these markets. The programmable and traceable nature of digital currency would make the digitalized renminbi nimble and effective internationally while reconciling China's need for capital control.

To launch the digitalized renminbi is a complicated task with a profound domestic and geopolitical impact. Compounded by the nCoV outbreak challenge, a black swan event earlier this year, it is unpredictable when exactly the People's Bank of China can start this process, though the coming year or two is more likely than in ten years. When it does launch, the world might divide into a U.S. dollar zone, a eurozone, and a digitalized renminbi-zone that likely contains a large part of the total global emerging markets. How the new financial power dynamic translates into global economics, trade, and foreign policies will shape our world in the coming decades.

The most desirable outcome is to adopt the IMF's special drawing right for international use.

JOSEPH E. GAGNON
Senior Fellow, Peterson Institute for International Economics

Private digital currencies with no intrinsic backing, such as Bitcoin, are novelty items with no long-term future. Digital currency backed by traditional national currency, as in Facebook's proposed Libra, has the potential to dominate both domestic and international transactions. But there are many concerns related to safety, privacy, and unintended social consequences that need to be sorted out first. National supervisory authorities, led by the Financial Stability Board, are already digging into these issues. The outcome remains far from clear.

There is a strong argument that public institutions, such as the International Monetary Fund and national central banks around the world, should take the lead in designing and managing digital currencies for both domestic and cross-border transactions. The logic is similar to that which led the world away from commodity currencies and private banknotes to government-run fiat currencies. It is too costly to have competing currencies trying to fulfill the same role within any given market. Within a cohesive economic unit, typically defined by a country's borders, money is a natural monopoly and there is no reason to entrust that monopoly to anyone but the government. Moreover, the macroeconomic benefits of independent monetary policies are too great to give up for any currency managed with other objectives in mind.

The most desirable outcome is to retain national currencies for domestic use and to adopt the IMF's special drawing right for international use. Ideally, the SDR would be expanded to include all convertible currencies of countries with sound macroeconomic policy frameworks as determined by IMF staff. A digital SDR would be managed by the IMF much like an exchange-traded fund backed by sovereign debt of the component currencies. This would expand the market for non-dollar bonds, creating an extra incentive for sound macro policy in the countries whose currencies are added to the SDR. It would establish a symmetric global currency in which the dollar would have the leading, but not dominant, position. Countries would retain full independence of domestic monetary policy. The former governor of the Bank of England, Mark Carney, proposed something along these lines at the Fed's Jackson Hole conference last year.

Moving to a symmetric currency system would have little impact on U.S. economic sanctions, which derive their potency from the size of the U.S. market and the dominance of U.S. firms. Even if all trade were conducted in euros, few companies would give up access to American customers, suppliers, and investors in order to trade with Iran. But U.S. sanctions are a tool that can be effective against only a limited number of relatively small economies. They will have a diminishing effect as the combined economic size of their targets increases. At some point, the United States risks becoming the primary victim of its own sanctions.

The U.S. dollar will not be displaced as the dominant international currency without further drastic and provocative moves by the U.S. government.

RICHARD N. COOPER
Maurits C. Boas Professor of International Economics, Harvard University

When it comes to major changes in practices and behavior, a decade is a relatively short period of time. Thus, I conjecture the U.S. dollar will still be the dominant international currency in 2030. This despite Treasury Secretary Steven Mnuchin's efforts, I assume following President Trump's instructions, to undermine it. The U.S. dollar has been used for many decades to reinforce economic sanctions against North Korea and Cuba; and has been engaged more severely in recent years in sanctions against Russia, Iran, Syria, and Venezuela, including secondary sanctions, that is, sanctions against European and other foreign firms which deal with Iran, despite disagreements by European and other countries with the U.S. sanctions. These recent practices create a strong incentive for firms in other countries to find ways to trade with sanctioned countries without use of the U.S. dollar. Russia, for instance, has already greatly reduced its holdings of dollars in its official foreign exchange reserves, despite the use of dollars in its major export markets for oil, gas, and metals. It is allegedly pricing its sales of oil and gas to China in Chinese renminbi rather than dollars, as is normal practice.

China has for several years talked about and even urged international use of the renminbi, on the mistaken view that the United States derives much of its international status from widespread foreign use of the U.S. dollar. And the newly installed European Commission in Brussels has announced that it wants to promote the international use of the euro, a change from its earlier position of neutrality. Thus, for all these reasons we will probably see the erosion of international use, in its various forms of reserve holdings, trade invoicing, and securities flotation, of the U.S. dollar over the next decade.

But as stated at the outset, the U.S. dollar will not be displaced as the dominant international currency without further drastic and provocative moves by the U.S. government. And while its shares may decline somewhat, in a growing world economy its actual use will probably increase, thanks to its strong fundamentals of wide recognition, strong network effects, a large and liquid capital market, and simply inertia in past practices and behavior.

The most serious challenge for the dollar comes from the U.S. government itself.

LORENZO CODOGNO
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For decades, there has been no obvious contender to the U.S. dollar due to the United States' deep and highly liquid financial markets, investment-quality dollar-denominated assets, and respect for the rule of law. However, the role of the U.S. dollar as preferred global currency for commerce and trade has been challenged by the currencies of both the eurozone and China.

European problems during the debt crisis of 2011–2012 have somewhat undermined the standing of the euro. The lack of cohesion and the slow pace of economic integration is another factor. The eurozone has not been able to develop liquid and efficient financial markets to challenge U.S. dollar dominance, and to some extent, Brexit has further undermined euro-denominated markets. Europeans have not been able to deepen their single market for goods and services, and the situation, especially in financial services, is still fragmented. Since the crisis, the eurozone banking sector has been *de facto* renationalized, and the banking union project is advancing very slowly. There are still economic governance issues that need to be addressed.

More recently, the euro has increasingly become a funding currency to finance carry trades, which is not precisely the best way to achieve critical mass in financial markets and attract financial and real investments. As a result, the euro has hardly challenged the U.S. dollar over the past twenty years, and there is no sign that the situation will change substantially in the future.

China and its currency is a much more serious contender to U.S. dominance. However, recent trade wars and growing geopolitical rifts have, to some extent, threatened globalization and the openness of trade. The globalization that prevailed twenty years ago has changed skin, and it is no longer synonymous with trade openness. It now tends to re-focus the interest of international investors and companies in favor of the pivotal role of the U.S. dollar.

Efforts by private organizations, such as Facebook's Libra or the decentralized Bitcoin, to circumvent U.S. dollar dominance through new digital currencies are doomed to fail. Initiatives by central banks have a much higher chance of success. Financial institutions and firms have been digital forever, but the introduction of digital currencies sponsored by central banks would change the life of households. The diffusion of blockchain-based technologies increasingly allows cutting out the middleman, although it also raises issues for the storage of information and its trustworthy transmission.

The future of digital currencies is thus almost exclusively in the hands of central banks. A global digital currency, as called for by the Bank of England's Mark Carney, is thought-provoking. Yet studies by the European Central Bank and the Bank for International Settlements present much more realistic options.

Regulators and central bankers are still catching up with new technologies. Nevertheless, private initiatives are likely to clash with the strong desire of central banks to maintain a close grip on money creation, effectively limiting initiatives in the realm of digital payments technology. Monetary authorities are keen to maintain control not only over the payment systems but also over financial intermediation more broadly. In other words, unbacked "cryptocurrencies" will never take off (and probably those already in circulation are heading for a miserable landing).

Widely accessible central bank digital money, instead, would be a much more feasible and appropriate route for the future, but would not change the nature of money and thus not break national or currency area boundaries, as the launch of international currencies would. Therefore, digitalization would not allow national currencies to punch above their weight and challenge the role of the U.S. dollar.

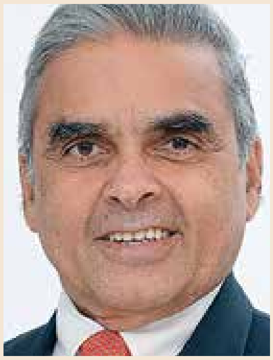
For good or bad, there seems to be no immediate risk of a substantial change in the current situation. Maybe the most serious challenge for the dollar comes from the U.S. government itself, and its desire to somewhat dis-engage from a multilateral approach to international relations, and distance itself from global economic and trade governance.

Dethroning the dollar will be unlikely.

MENZIE D. CHINN
Professor of Public Affairs and Economics, University of Wisconsin

The dollar will retain its primacy as an international currency as long as America maintains large, liquid, and open financial markets. Those liquid markets are made possible by the ability of the U.S. government to generate safe assets. Until issuers of a digital currency can circulate an asset that has the attributes of safe assets like U.S. Treasuries, dethroning the dollar will be unlikely. The likelihood of a substantial role is particularly low for privately issued digital currencies, given the volatility in price and their untested characteristics. If financial disruptions occur, such as a run, it seems likely that use will be concentrated among those who seek to avoid regulations and capital controls.

Digital currencies issued by central banks, on the other hand, could become important as another form of international currency, since they would be backed up by collateral. How successfully they do so depends in large part on the benefits of digital currencies versus the costs of using them in transactions and as a store of value. (But then, a central bank digital currency is unlikely to be anonymous.) If U.S. monetary and fiscal policy, combined with restrictive regulatory policies, threaten the ease by which cross-border transactions are effected, then erosion of the dollar's role might be substantial, perhaps raising borrowing costs for Americans. Still, the world has survived multiple international currency regimes, and will do so again.



The dollar could become the Achilles heel of the American economy.

KISHORE MAHBUBANI
Distinguished Fellow, National University of Singapore's Asia Research Institute; Founding Dean, Lee Kuan Yew School of Public Policy; and author,* Has China Won?: The Chinese Challenge to American Primacy *(Public Affairs, 2020)

Yes, the role of the U.S. dollar as the global reserve currency could become the Achilles heel of the American economy.

The key issue is trust. The U.S. dollar is manufactured and controlled by one country, the United States. Yet the 7.2 billion people outside the United States are happy to use it, both as a store of value (for their reserve currencies) and as a unit of exchange (for their international trade) because they trust the U.S. government to protect both the interests of the United States and the rest of the world in the management of the U.S. dollar.

In return for this global trust, the American people enjoy an "exorbitant privilege" of being able to live beyond their means. As Morgan Stanley chief global strategist Ruchir Sharma wrote in the *New York Times,* "Reserve currency status had long been a perk of imperial might—and an economic elixir. By generating a steady flow of customers who want to hold the currency, often in the form of government bonds, it allows the privileged country to borrow cheaply abroad and fund a lifestyle well beyond its means. … And for nearly a century now this privilege has helped to keep United States interest rates low, making it possible for Americans to buy cars and homes and, in recent decades, run large government deficits that they could not otherwise afford." Since both the rest of the world and the American people were benefiting, it was a happy "win-win" arrangement.

The U.S. government has therefore made a major strategic error in trying to convert this "win-win" arrangement into a "win-lose" arrangement. Not satisfied with the "exorbitant privilege" already enjoyed by the American people, the U.S. government also wants to use the U.S. dollar as a weapon to punish other countries, both allies and adversaries. Under international law, the Joint Comprehensive Plan of Action—the Iran nuclear deal—is legal because it has been endorsed by the UN Security

Council. Yet if European companies try to trade with Iran, they would be punished by unilateral U.S. sanctions based on the indispensability of the U.S. dollar. The dollar used to be a friendly tool, but has become a razor blade cutting the fingers of those who hold it.

The assumption of U.S. policymakers who have weaponized the U.S. dollar is that there is no alternative. In the short run, this is true. Yet as I document in *Has China Won?,* many countries would welcome a new unit of measurement, based on blockchain technology and protected by the People's Bank of China, to use for their bilateral trade. None of this will happen overnight. By undermining trust in the U.S. dollar and creating a massive incentive for other countries to find alternatives, however, the United States has laid the groundwork for other currencies and units of measurement to emerge to facilitate international trade.

It's true that the role of the U.S. dollar in international financial transactions is far greater than its role in international trade. Yet just as a house of cards can fall by the removal of one critical card, the overall role of the U.S. dollar globally could shrink if it's no longer the dominant currency for international trade. If this happens, the capacity for Americans to live beyond their means could be severely curtailed. This is why the role of the U.S. dollar as the global reserve currency could become the Achilles heel of the U.S. economy.

Financial sanctions are effective. But the cost to the United States will be high as alternative payments mechanisms increase in importance.

ANNE O. KRUEGER
Senior Research Professor of International Economics, Johns Hopkins School of Advanced International Studies, and former First Deputy Managing Director, International Monetary Fund

The U.S. dollar has been a "global public good" at least since the end of the Second World War. It has served the world and the United States well. Economist Milton Friedman long ago showed that a single global currency would be best if all countries followed the rules. The dollar has been the preeminent unit of payment and the major medium of exchange for international transactions. It has thus become virtually a single currency for financial transactions, which has almost met Friedman's ideal.

The dollar filled that role because it was a convertible currency, because U.S. credit was unquestioned, and because of the size of the U.S. economy and the fluidity and depth of its financial system. Even after the introduction of the euro, the share of global transactions invoiced in U.S. dollars hardly fell.

However, recent American actions have changed the calculation. The Trump administration has bargained bilaterally and used financial sanctions for many purposes. It placed around a thousand sanctions on goods and financial transactions in each of the past two years.

Sanctions on a country's trade are only partially effective unless the world community enforces them because it is relatively straightforward for the sanctioned country to trade through third countries.

Financial sanctions are different because of the virtual monopoly the United States holds on the international payments system. Bilateral financial sanctions by the United States in effect have become multilateral. In earlier years, the United States largely refrained from using financial sanctions except in extreme cases. It instead supported the World Trade Organization and the rule of law in international trade.

But the United States has abandoned that support and chosen instead to use its monopoly power to pressure countries bilaterally to yield to American pressures. Foreigners witness the bargaining power the United States has, its willingness to use it capriciously for addressing real and imagined issues, and the stranglehold the United States can impose on a sanctioned country's trade or assets. As this persists, they will become increasingly anxious to find ways around the monopoly.

The costs of breaking away from financial dependence on the dollar are not small: it is enormously convenient to have a single currency for international transactions in a world of more than two hundred countries. But as it becomes increasingly evident that the United States employs sanctions almost at whim, the authorities elsewhere will become increasingly willing to pay a premium, if necessary, to reduce the vulnerability of their trade and finances to sanctions.

Financial sanctions are effective in the short run. But in the longer term, the cost to the United States will be high as alternative payments mechanisms increase in importance and undermine the American monopoly.

It is possible that the U.S. departure from the open multilateral trading and payments system will be reversed. If not, the global role of the U.S. dollar will diminish as the use of other currencies and means of payments accelerates.

The U.S. will be able to get away with its "exorbitant privilege" for longer than normal economic forces might suggest.

JIM O'NEILL

Former Commercial Secretary to the Treasury, United Kingdom, and former Chairman, Asset Management, Goldman Sachs International

There have been repeated periods of doubt about the sustainability of the global role of the dollar since I first started in the world of international finance in 1982. None of them have turned out to be true. So is the dollar's role impervious to the arguments that so many have intermittently raised? I guess it is the case, ultimately, that if the United States were not to remain the most dominant economy in the world, then it is highly likely that at some unknown point the dollar would suddenly lose its dominant role. After all, this is what happened with the role of the sterling, which at a point in history did dominate world financial affairs in line with the United Kingdom's historic global economic importance.

In this regard, a large part of the ultimate question is whether the United States will stop being the world's largest economy. Put another way, in current popular jargon, will China take over from the United States, or will all these predictions—of which I myself have been in the forefront in making—turn out also to be as inaccurate as the supposed coming dominance of Japan predicted in the 1970s, or the many times the dollar's demise has been suggested?

I do find myself thinking that the United States has, under Donald Trump, seemingly developed some almost paranoid-type stance about stopping China from becoming the world's largest economy, and while it has also been partly self-destructive, it certainly appears to have been the case that the trade strategy against China has contributed to China's slowing economy. I am not sure how wise and persistent this policy can be, as if and when the consequences become more negative for the United States—as they probably will—this near-obsession with the policy might retreat. And without having any confidence about this path, I don't see China's ongoing rise in share of global GDP being ultimately stopped by this. Ultimately, China will find more and more other trade partners, diminishing the importance of the U.S. strategy, and more likely even, undertake stronger domestic reforms to diminish the overall importance of domestic trade. This means that, at some point, China will have to confront, under its single-party system, the real dilemma of having to take a stronger lead in the world financial system, perhaps even when its own domestic financial system is not fully developed.

This comes to the crux of the issue, and why this question now under Trump has become so valid. What has become so clear under this president is that, indeed, the United States can use the powerful role of the dollar, and the U.S. dominance of the financial system, as effective tactical weapons in its global agenda, whether they be sanctions or more normal trade deals. This has highlighted the problem for other countries, perhaps exemplified by Russia, of their vulnerability. In this sense, it is most interesting to see the deliberate policy to reduce the role of the dollar in Russia's financial affairs as well as part of Russia's foreign affairs. And it wouldn't be surprising if other countries were embarking on the same path, although perhaps with less public fanfare than the Russians.

But ultimately, and this is also the crux, unless China, or perhaps even the continental Europeans with the euro, actually want the responsibility—and occasional vulnerabilities—that come with being a reserve currency, the United States will still be able to get away with its "exorbitant privilege" for longer than normal economic forces might suggest.

The only likely candidate to succeed the dollar is the Chinese yuan.

NORMAN A. BAILEY

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The first international reserve, trading, and investment currency was the Roman silver denarius. Following the devaluation of the denarius by Diocletian, Emperor Constantine reformed the currency by replacing the denarius with the gold solidus, which morphed into the bezant, as the Roman Empire became the Byzantine Empire. The solidus/bezant easily holds the record for longevity, having remained the international currency for eight centuries.

Following the conquest of much of the heartland of Byzantium by Turkic tribes in the eleventh century, the bezant was devalued and succeeded as the international trading currency by the Venetian gold and silver ducat. In its turn, the ducat was replaced by the Spanish and then the British currencies and in the twentieth century by the U.S. dollar.

Over the centuries, the following characteristics have characterized the dominant international trading, reserve, and investment currency:

- The country issuing the currency dominates international trade in terms of value.
- It must have the most powerful navy in the world, and in the modern age, also air force.
- It must maintain the value of its currency *vis-à-vis* the currencies of other significant countries. This does not mean maintaining its value in absolute terms or in terms of precious metals.

As the American global imperium implodes, beginning in the G. W. Bush administration, the dominance of the dollar has come into question, although in historical terms the transformation has been gradual, unlike the defeat of the Byzantines by the Seljuk Turks, of the Venetians by the League of Cambrai, of the Spanish at Trafalgar, or the exhaustion of the British empire as a result of World Wars I and II. On the contrary, the absolute world dominance for the first time by a single political entity, the United States, from 1989 to 2001, has been followed by a process of hubris-driven over-extension and consequent loss of hegemonic coverage since that time. The "End of History" lasted a decade until history took over again.

At present, the only likely candidate to succeed the dollar as the international currency is the Chinese yuan (or renminbi). China is busily and so far successfully engaged in building the necessary conditions for the yuan to replace the dollar. Its trade volume is huge and its GDP equivalent to that of the United States. The value of the yuan in relation to other currencies has significantly appreciated over time, and the Chinese are increasing their naval and air capabilities not only in terms of equipment and size, but also in term of international coverage, with dominance in the East and South China Seas and naval bases in Sri Lanka, Pakistan, and Djibouti. Coupled with the possession of a sizable nuclear arsenal, it is not clear that China would not be able to prevail in a war with the United States. Finally, the pharaonic Belt and Road initiative, mimicking the route used so long ago by the Romans and the Chinese to exchange silk for the silver denarius, is demonstrating the Chinese challenge to the United States throughout Asia, the Middle East, and Africa, and the Confucius Institutes are doing the same in the cultural realm.

Which brings us to the question of whether the next international currency might be not the currency of any political entity, but a virtual "currency." My answer to that question is indicated by the use of quotation marks. So-called virtual currencies are not currencies at all in the traditional sense of the word. They are the digital equivalent of poker or roulette chips—backed by nothing at all and subject to constant manipulation leading to abrupt gains and losses. As such they are a perfect medium of exchange for criminal and terrorist organizations and entirely unsuitable for legitimate commerce.

The greenback still looks set to remain Number One.

HOLGER SCHMIEDING
Chief Economist, Berenberg

The emergence of a multipolar world and the rise of digital technologies are transforming the global monetary system. The process looks set to accelerate in the next few years. It will affect the different functions of money, and in particular those of the U.S. dollar, in different ways. Rattled by President Donald Trump's aggressive use of America's financial clout for political purposes, the European Union is trying to rein in the extraterritorial effects of U.S. sanctions against political adversaries. China will continue to use the terms of access to its huge domestic market and its foreign investments to strengthen the role of the renminbi.

As digital technologies make it ever easier to conduct and settle cross-border payments, the role of the dollar and of traditional financial intermediaries will decline further. The partial separation of the world economy into different technological spheres around the United States, China, and—in some regulatory aspects—also the European Union will add to that. As a medium of international exchange, the greenback will likely play a smaller role some five to ten years from now. To a lesser extent, this will also limit the role of the U.S. dollar as a unit of account.

Whether this will seriously dent the dollar's dominance as the ultimate safe-haven store of value is a very different matter, though. The United States still offers an unrivaled combination of the rule of law, political stability, economic clout, and military might. China's red emperor, overlording an impressive but fragile and credit-driven economic expansion coupled with a premature and expensive grab for more regional and global power, cannot offer investors a safe haven they can trust when the going gets rough. A dictator guided by whatever his self-interest may be and not bound by any rule is no match for the fundamental institutional strength of the United States. In some respects, the European Union and the European Central Bank provide an institutional set-up comparable to or even superior to that of the United States. But the region will continue to lack the internal political cohesion and the complete integration of its financial markets needed to eventually rival the United States for currency dominance.

Digital currencies issued by the private sector are a great idea. In weaker jurisdictions and/or mismanaged economies and financial systems, they could turn into immensely useful alternatives to local monies. But to be trusted as ultimate stores of value, they would need to be based on enforceable contracts with a high degree of deposit protection. Only strong and rich countries under the rule of law can offer that.

The United States is far from perfect. The rise of Donald Trump and Bernie Sanders has revealed some serious flaws in its deeply polarized political system. Nonetheless, no digital company or conglomerate can come close to the safe haven status of the United States for the foreseeable future.

The role of the U.S. dollar will change and diminish in some respects in the next ten years. But the greenback still looks set to remain Number One.

America's flexibility and role will only be enhanced, not diminished.

JAMES E. GLASSMAN

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The role of the dollar in the international financial arena is likely to be joined in time by other currencies as ongoing economic development and embrace of market-based principles create new economic powerhouses (and, of course, competitors). Innovation in financial technology will enhance, not diminish, the role of the U.S. financial system. Counterintuitively, this trend will be favorable for the United States, because the economic forces that will give rise to financial alternatives and alternative currencies—greatly expanded market opportunities, higher living standards, and reduced international trade imbalances—will be far greater than the modest benefits that the United States currently enjoys as a result of the dollar's role today as an international reserve currency.

The value of the dollar and U.S. financial system in international commerce is much broader than a facilitator of international commerce. The dollar's international reserve status symbolizes the economic energy that the U.S. economy, including its consumer markets, and its deep and broad financial markets that are largely free of political influence, offer. The rationale for international holdings of dollars has evolved over the decades. Foreign governments used to accumulate large war chests of dollars to peg their currencies to the U.S. dollar in the Bretton Woods fixed exchange rate system after World War II. They had no reason to hold dollars, however, when the system was abandoned in the early 1970s and currencies were free to float. And in an era of floating exchange rates, there is little need to amass large portfolios of currencies to weather currency crises.

In the new millennium, the ambitious development agendas of emerging economies have accompanied large trade surpluses with the United States. Emerging economies need to recycle their surplus dollars back into dollar assets to avoid driving their currencies up. They have few alternatives. (Economists often describe the foreign demand for dollars in the modern era as a Bretton Woods II system, referring to the voluntary decision by emerging economies to stabilize their currencies to the dollar to promote their economic ambitions.) So the attractiveness of the U.S. financial system lies in its accessibility to others. This is why—ironically, given criticism of the dollar-centric international financial system—foreign holdings of dollar-denominated assets have been expanding more than 8 percent annually in this millennium, up five-fold to $33.3 trillion since the end of the 1990s. International accounts now hold almost half of U.S. securities.

That backdrop implies that the rise of alternative currencies and financial systems will be evolutionary, one where change will be measured in decades, not years. The attributes that make the U.S. financial system so vital to international commerce—open capital account free of cross-border restrictions on the movement of capital, deep and liquid markets, transparent pricing, rule of law, market-based economic system, and political stability through many economic cycles—will come slowly for alternative financial systems.

How will the dollar, and thus America's financial flexibility, be affected by this coming brave new world of digital payments technology, if at all? If the dollar were to face growing competition from rivals, without an expansion in global commerce—that is, everything else the same—its stature would gradually diminish. But that isn't likely to be the case. The economic forces that will lead to the development of alternative financial systems will accompany expanding international commerce and economic opportunities. In that case, America's flexibility and role will only be enhanced, not diminished.

If using the dollar comes with an elevated perception of risk, its use will ultimately become less common.

NICOLAS VÉRON

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The dollar is dominant because it is so much safer and more convenient to use than any other alternative. If, however, using the dollar comes with an elevated perception of risk, its use will ultimately become less common. This is what may happen if the Trump administration's incontinent use of financial sanctions is maintained over the next few years.

The United States has wielded financial sanctions for a long time, and their use has been renewed and expanded following the attacks on September 11, 2001. Even during the 2000s and until the end of the Obama administration, however, there was a keen awareness within the U.S. executive branch of a fundamental trade-off. Sanctions were viewed as a powerful tool that could bring effective benefits to U.S. foreign policy; but if they were used too aggressively, their effectiveness would be blunted by the incentive created for non-U.S. actors to move away from using the dollar for their international transactions. Thus, the best possible use of sanctions was targeted and parsimonious.

That caution has, like so many other things, been thrown out of the window by the Trump administration since 2018. The administration has either imposed sanctions or threatened them on the business interests of Oleg Deripaska in Russia, the companies involved in building the Nord Stream 2 gas pipeline between Russia and Germany, Turkey, Iraq, and more. Its scattershot moves have seeded a perception that U.S. sanctions may possibly hit anyone anywhere in the world, based on essentially unpredictable whims.

Given considerable inertia in such matters, this perception has not yet led to very widespread changes of behavior. If Donald Trump is reelected, however, the unpredictability of sanctions could well become an entrenched belief that is part of a "new normal" set of assumptions. If, by contrast, Trump loses this year's presidential contest, it is likely that the new administration will review the use of sanctions, and that of trade tariffs too, with the aim to reassure traditional allies that the U.S. government is keen to mend fences.

The dominance of the dollar is fundamentally linked to its assessment by a critical mass of market participants as the least-risky currency to use as reference. If, in the calculus of most players, using the dollar becomes structurally more risky than, say, the euro, then a massive shift in financial behavior could happen within a few years. True, one could hope that a second Trump term might be more moderate in international policy than the first one, as happened with George W. Bush. Nothing in the Trump administration's track record so far, however, provides comfort that such a hope is more than wishful thinking. ◆

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