NCAER Podcasts: Episode – 3 (Part-2)

Topic: Beyond the Dollar: Emerging Economies & the New Financial Order

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Transcript:

UD: Namaste and welcome back to the second part of our two-part episode of the NCAER podcast series. I'm your host, Udaibir Das, and I'm excited to continue exploring the intersections between global macroeconomics and international finance and what this might imply for emerging markets and developing economies. In part two of this NCAER podcast, Barry Eichengreen and I will continue to discuss the US dollar's outlook, dominance, and implications. We'll delve deeper into the US authorities' stance on the dollar's international role, its impact on growing economies like India, and a sensible approach that we can have on dollar's future. But before I resume with Barry, let me leave you with a question. I'll provide the answer at the end of our podcast. The question is that under the Bretton Woods Agreement, the US dollar was backed by the Gold Standard. What backs the US dollar today, and how is its value determined? But first, let's talk with Barry.

So, Barry, are the US authorities worried in any manner about all these discussions and viewpoints? And have they asked you, for example, on what your views are, given the fact that you're one of the very few who have very meticulously studied this over decades? And I think somebody you might know, and my good friend Mark Sobo, who's the chairman of the London-based think tank OMFIF, formerly from the US Treasury, has expressed concern in an FT post that American dysfunction is a significant threat to dollar dominance. He alerted the readers to what he called 'malign scenario' for the US versus a benign scenario that we all live in presently about the US dollar.

So, I suppose, as you were saying earlier, that some level of politics and national security considerations are now coming in to determine the future of US dollar rather than sound economics and market dynamics. I'm sure that this was not in the minds of those who met in Bretton Woods in 1944 and later in the Jamaica Accord and so on. So, is there another agreement like the Plaza Accord of 1985 needed really to settle the future of dollar and reset its role? I mean, after all, how long will central banks keep on intervening in international markets or bilateral country-level coercion tactics used or talk about tax levy being placed on foreign holdings of US dollar, Barry?

Barry: I don't think there is scope for another Plaza Accord or another Bretton Woods conference at the moment because there is no consensus on what to do with today's highly liquid open financial markets, an intervention in the foreign exchange market like the Japanese evidently did last week. I think it will only have transient effects and fundamental changes in monetary policy at the national level to stabilize exchange rates won't happen because monetary policies are appropriately directed today at domestic objectives-- keeping inflation low and stable and so forth. But you're quite right that there will be more worries about the dollar going forward. They will be more intense or less intense depending on, among other things, the outcome of our presidential election in November for three reasons, two of which you mentioned. One is further weaponization of the dollar. The fact that the US imposed sanctions on Russia and froze its dollar reserves didn't undermine the international role of the dollar because we did that in cooperation with G7 partners, so that moving toward the euro, pound sterling, Japanese yen was not an alternative for countries worried about this because all of their governments moved against Russian reserves simultaneously.

Would international cooperation happen under a Trump administration, second Trump administration, President Trump? Former President Trump not being famous for cooperating with foreign governments. Would there possibly be a scattershot application of sanctions by the next US administration? Could there be a conscious effort to push the dollar down in order to enhance US export competitiveness, as Mr Trump's new running mate, J.D. Vance, suggested? … and how would foreign governments react to that and the third factor which you didn't mention is the US government's financial position. Going forward, there is no immediate crisis of debt sustainability in the United States but looking out a decade and more, the US debt to GDP ratio will continue to rise and we are going to have to raise more tax revenues to finance government spending, not something that many people in Congress, many of the Republicans in Congress or candidate Trump are inclined to do. And if there are worries about the sustainability of US finances and therefore about the value of US Treasury bonds, how will foreign governments and central banks react to that? So, there are grounds for concern.

UD: Yes, and just I think Robert Lighthizer's view, who's the Trump's sort of brain on this issue, is pretty much … he came out with a book, I think … that dollar is too strong, must be weakened, because a weak dollar, in his view, is what the United States needs to reduce its trade deficit. So yes. Barry, this last point that you mentioned about the link with the United States financial position, isn't it something that you spoke about in the last Jackson Hole Economic Policy Symposium? And living with high public debt, and in that discussion, I don't think you explicitly mentioned this in the paper speech presentation, but were there any concerns about the dollar dominance and how it might interact with high US public debt?

Barry: We touched on. Sirkin and I touched on that issue very lightly, if you will, because I think those concerns can be exaggerated if you look at the projections of the IMF or the US Congressional budget office going out a decade, the US debt to GDP ratio rises very modestly, not enough I think to raise serious concerns internationally all by itself but looking further out there then becomes an issue because of demographic change, because of the aging US population, because of rising pension and healthcare costs. My view, as I said before, is that the US is an outlier, not because we spend more than other countries on social programs, for defence, but because we raise less tax revenue than other advanced economies and because we lack the political will to do something about that.

UD: So, Barry, in this podcast up to now, we have mentioned international monetary system a few times. I think you and I know well what that is. Maybe you can... My next question is really more about something that you mentioned in your book, Exorbitant Privilege, and which discusses how post-World War II institutions like the IMF reinforced the dollar's global prominence. I mean, I think that book, you said something in those lines. So my question is, do you still hold that position? And I think you had also mentioned that the rise of China and the Eurozone as potential challenges to the dollar dominance, but then I believe your view is that significant shifts would need substantial structural changes in the global financial architecture. I mean, I don't know whether you meant the international monetary system here or more the micro aspects of the monetary financial system. And I'm raising this because you know that many scholars and policymakers, and I believe you too, have argued that the IMS or the International Monetary System is indeed overdue for reform. So, it's a lot of questions. I don't know, you may want to unpack this, but my thing was, do you still believe that that things that you believed in when you came out with that book, Exorbitant Privilege, still hold? And if you were asked today to give one or two essential areas of reform, what would they be?

Barry: The International Monetary Fund is at the center of the global payments and lending system. It worries about exchange rates. global imbalances, financial stability, which is basically what we're talking about when we talk about the international monetary system. So, I would start with IMF reform, which means reforming the governance of the fund. So, countries including emerging markets have a louder voice in decision-making and leadership selection in the fund, there is the fact that the system of currency swaps and credits, you mentioned that by citing some remarks by Gita Gopinath, who's number two at the fund, that system is partial and fragmented. So the Federal Reserve System provides swap lines to a subset of America's friends but not globally, important countries are left out of that system of dollar swaps. And you know who I'm talking about here. So, I think giving the fund more capacity to provide liquidity lines and credits is important as well. That's where I would start.

UD: Excellent. And I suppose that takes us to the fact that that would mean that emerging markets and where they are presently situated in the architecture would obviously have to be re-examined as well. You so nicely reminded us all about the fact that at the 1944 Bretton Woods Conference, India was one of the 44 countries. At that time, India was not independent. So I think, I believe, correct me if I'm wrong, Barry, I think the Indian team went along with Lord Keynes and the British contingent and sat with them. But they pledged to reconstruct a war-ravaged world, promote development leading to the construction of creation, sorry, of the IMF and the World Bank, and India became a founding member. And if I recall correctly, there were other emerging markets as well, Barry, right? China, Mexico, Chile, I think Brazil too. Now, in your book, Globalizing Capital, which I really like a lot and I use it in my lectures and outreaches, you mentioned that emerging markets often face volatility due to their reliance on the dollar. and which can be destabilizing. It could destabilize both the flows and the price exchange rates. So, looking ahead, given the history of emerging markets, given what the reform of the IMF, I mean, what would a continued dominance of dollar mean for these economies? I mean, should they, from a policy point of view, look at it as a curse or should they view it as an opportunity or must they think that the current phase is one of transition and best is to hold and wait?

Barry: Emerging markets have benefited tremendously from globalization without question. And a global economy needs liquidity, international liquidity, to grease the wheels of international trade, foreign investment, international payments. So, the dollar is the dominant source of that liquidity. As we discussed before, I think the world economy would probably be safer if it had a more diversified set of liquidity sources, not only through the good offices of the federal reserve system in the US government but if something went haywire in the United States politically, economically, financially, if there were alternative sources of liquidity in addition to the dollar that would help to secure globalization that would be good, therefore, by implication for emerging markets. So, I think there are superior alternatives to exclusive reliance on the dollar from the point of view of commercial markets.

UD: So, if India or Indian policymakers were to ask you for your views, and this all looks highly uncertain. There are a number of scenarios for the future of the US dollar's global supremacy. We could see shifts in global financial power and capital flows. We could see the rise of other currencies, including potentially Indian rupee. So, there will be a lot of unknown knowns or, you know, things that are still evolving. And it'll take time. What should then be the kind of reforms or what should be some of the safeguards that you think countries like India could and should consider in the interim.

Barry: India should remain a voice for IMF reform as we talked about before so that emerging markets acquire more influence in the fund, more voting power. India should continue to promote use of its currency in cross-border, trade-related transactions. So, the fact that India has capital controls of various sorts limits its ability to promote the use of the rupee for capital account, financial account transactions. But it can move ahead, as China has done, in encouraging exporters and importers, not only in India itself, but in the country's trading partners to use its currency for cross border payments. So that didn't work with Russia, where it was tried in the last couple of years, but it could work with other trading partners in the world economy.

UD: Thank you so much, Barry, both for joining us and for a very illuminating conversation. And I must also appreciate the candour with which you have come out on some very sensitive issues relating to the dollar and where it might be headed. And I hope we get another chance to have a conversation, may be next year, seeing where things land up post the elections in the United States.

Barry: I look forward to doing it again next year.

UD: Yes, let's see where the world is.

UD: That wraps up my two-part conversation with Barry Eichengreen. I hope our discussion has enriched your understanding of the US dollar's global dynamics as a reserve and a transactional currency. The question I posed at the start of the podcast was, what backs the US dollar today and how is its value determined? I'm certain that most of you know it or have got it right, but here is the answer. The gold standard no longer backs the US dollar as it was until 1971. Today, the dollar is considered a fiat currency, a term that broadly refers to a currency that is not backed by a physical commodity like gold or silver, but rather by the trust and confidence in the stability and output of the US economy. It's backed by the US government's ability to generate revenues, its authority to compel economic participants to transact in dollars, and the full faith and credit of the US government. How is the value determined? The value of the dollar today is determined in the open foreign exchange markets where various factors, including the relative economic strengths of countries, interest rates, and other macroeconomic factors influence it. On a final note, your participation and feedback are vital to a shared learning journey.

Please email us at **info@ncaer.org** with any questions or requests for further clarification. We will do our best to respond promptly, and if needed, I'll be delighted to chat with you. So, until next time, goodbye, namaste, and remember, while economic policy is what it is, it can always be different.