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The dominant role of the dollar in the international monetary and financial system is an asset, not a handicap, for the United States

A widely held view in circles close to Donald Trump (in particular by Stephen Miran[1], who is the new chairman of the Council of Economic Advisors) is that the dollar's dominant role in the world economy is a handicap for the United States, because the high level of demand for dollars is causing an overvaluation of the American currency, and is the cause of the deindustrialisation of the United States. Hence the proposal to force other countries to sell part of their dollar reserves, in order to cause the dollar to depreciate, under the threat of tariffs that would be imposed by the United States if they refused to sell dollars and appreciate their currencies.

However in reality, issuing the currency that plays the dominant role in the international monetary and financial system is an advantage. This situation makes it possible to attract international capital, to maintain a very large external deficit and a growing external debt, and to finance investments with international debt. The modernisation of the US economy made possible by the dollar's 'exorbitant privilege' more than compensates for the loss of low-end industry due to the strong dollar.

Additionally, the decline in global demand for dollars, and US Treasury securities, would not only lead to a depreciation of the dollar, but also to a sharp rise in US long-term interest rates. Stephen Miran imagines forcing countries to buy very long-term Treasury debt. But if these purchases offset sales, there will be no depreciation of the dollar.

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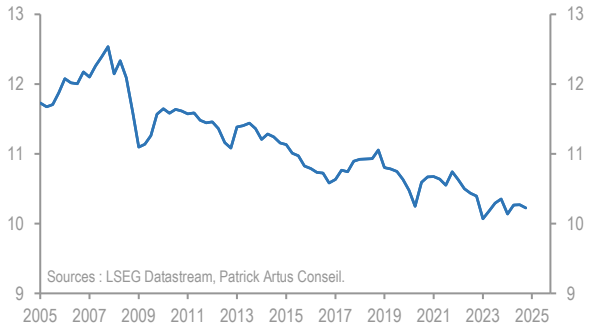
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(1) Miran, S. (2024). A User's Guide to Restructuring the Global Trading System. *Hudson Bay Capital. www. hudsonbaycapital. com/documents/FG/hudsonbay/research/638199_ rs_Guide_to_ Restructuring_the_Global_Trading_System. pdf.*

Economists close to Donald Trump believe that the dollar is overvalued and that its role as the dominant reserve currency is a handicap for the United States.

Economists close to Donald Trump (in particular Stephen Miran, Chairman of the US President's Council of Economic Advisors) believe that **the dollar is overvalued**, due to its dominant role in foreign exchange reserves and financial markets, and **that this overvaluation of the dollar is the cause of the de-industrialisation of the United States** (**Chart 1**).

Chart 1
United States: Real value added in manufacturing (as % of real GDP)



If we look at the dollar exchange rate since 1995, we see that the dollar has appreciated against the euro since 2008, against the yen since 2012, against the Chinese RMB since 2014 (**Charts 2A/B**) and against all currencies since 2008 (**Chart 3**).

Chart 2A
United States : Exchange rate against RMB and euro

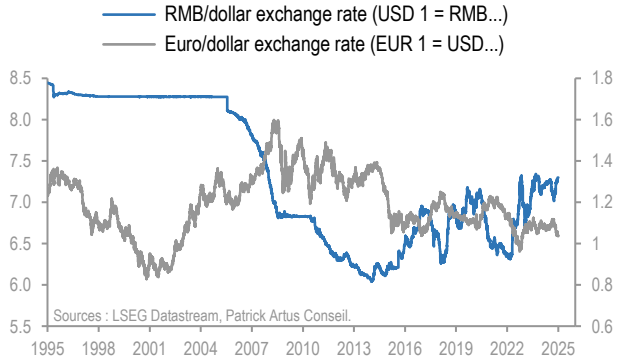


Chart 2B
United States : Exchange rate against the yen (USD 1 = JPY...)



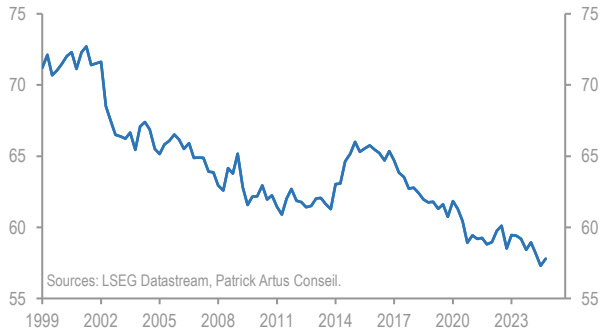
Chart 3
United States : US dollar Index DXY



Given that the dollar was weak from 2004 to 2014, we can see that the decline in the weight of manufacturing in US GDP does not actually seem to be linked to the dollar exchange rate.

But Donald Trump, advised by Stephen Miran, believes that the dollar is structurally overvalued, in particular because of its role as the dominant reserve currency (Chart 4).

Chart 4
World: Weight of US dollar in the global foreign exchange reserves (as %)



Hence the proposal to force other countries, under threat of very high tariffs on their exports to the United States, to sell part of their dollar reserves, thus reducing the dollar's role as a reserve currency, which would lead to a depreciation of the dollar.

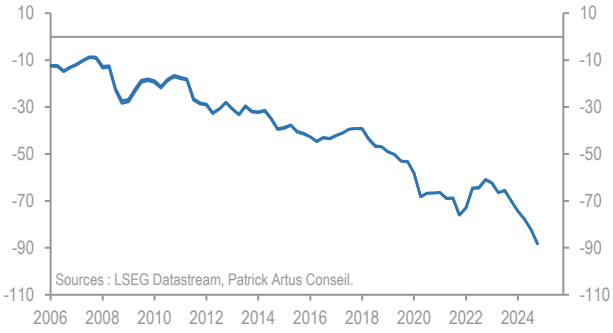
But in reality, issuing the dominant currency is an asset

The dominant role of the dollar in the international monetary system has enabled the United States to **run a perpetual external (current account) deficit (Chart 5) and to accumulate a very large net foreign debt (Chart 6)**.

Chart 5
United States: Current account balance (as % of nominal GDP)

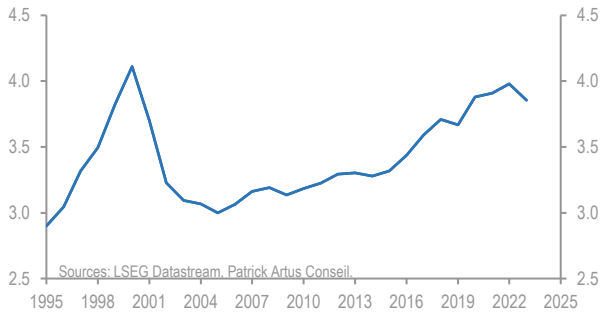


Chart 6
United States: Net external debt (as % of nominal GDP)



This has enabled the United States **to finance very substantial investment, particularly in new technologies (Chart 7)**, which would not have been possible without capital inflows from non-residents attracted by the status of the dollar.

Chart 7
United States: ICT investment including software (in value terms, as % of nominal GDP)



The move upmarket in the US economy was therefore financed by the 'exorbitant privilege' of the dollar. Capital inflows led to an appreciation of the dollar, which was not permanent (see Charts 2a/b and 3 above), but if there was deindustrialisation, there was also rapid development of new technologies.

Summary: abandoning the dollar's role as the dominant reserve currency would be a serious mistake for the United States

The dollar's role as the dominant reserve currency has attracted capital to the United States, which has financed the new technology industry. Losing the dollar's role as the dominant reserve currency would mean having to balance the US current account, as the US would lose its attractiveness to international capital and thus trigger a recession in the US.

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