IS THE DOLLAR STILL WORTH A BUCK?

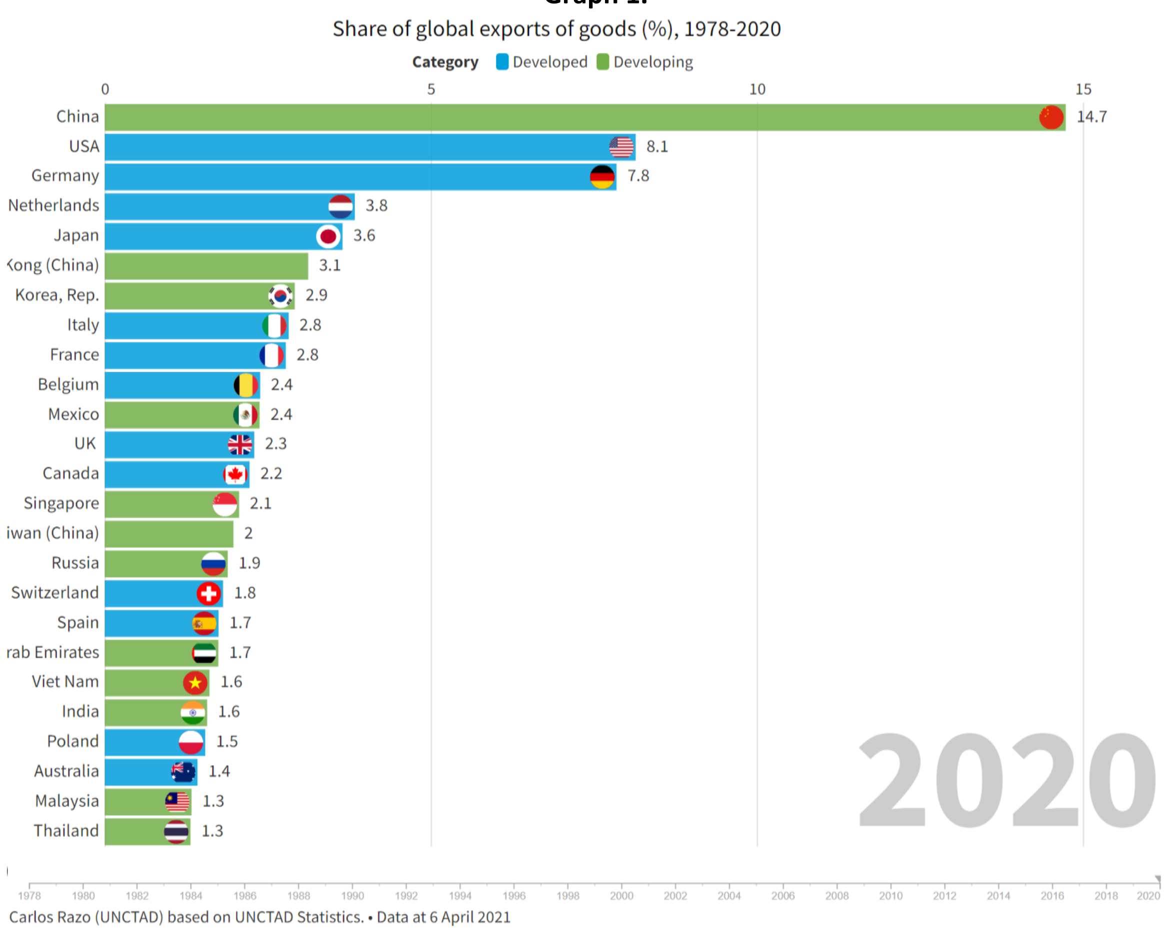
The frequency and intensity of the discussion about the possible even probable demise of the Dollar as the world's de facto reserve currency has reached a new level. This article investigates the merits as well as the demerits of the various propositions.

Not since 1985 has there been such extensive discussion over the demise of the Dollar. Then it was provoked by the industrial march of Japan, now it is China's march which threatens the Dollar. This is no longer a theoretical discussion but one based on material developments both political and economic.

China is by far the world's largest industrial economy. In 2021-22 it absorbed 50% of all the material inputs and components produced around the world. A significant proportion of these inputs were turned into final goods not for the account of Chinese firms but on behalf of imperialist multi-nationals and importers. China still lags in key technologies and it lacks true multi-nationals though this is changing rapidly. Nevertheless the size of the economy now means China is the biggest trading partner for an increasing number of countries.

This can be seen in this amazing graphic prepared by UNCTAD which shows the relative strengths of exporters between 1978 and 2020. In 1978 China barely featured as an exporter. By 2022 China exported the same amount as the US and Germany combined, even without adjusting for an undervalued Renminbi.

Graph 1.



China has also adopted a more assertive foreign policy born out of necessity given the efforts by the USA to contain it and by the possibilities generated by the economic might of its economy. Its biggest diplomatic success to date has been in the Middle East where it has brokered a peace deal between Iran and Saudi Arabia leading to a peace treaty in Yemen. The US, which has previously provoked antagonisms and conflict in the region to prevent the emergence of a common market based on oil wealth there, has effectively been side-lined. Israel recognises this and now has to confront the new reality that it is a product of the American Century on which the sun is now setting. China on the other hand does not fear Gulf competition but seeks to enhance their economic prospects via the *belt and braces* initiatives. Clearly this closer co-operation will begin to imperil the *Petrodollar* as more oil is traded in Renminbis.

The same Dollar substitution is taking place between Russia and China, and by Russia and some of its trading partners. New Payment Systems have been put in place to skirt around Western Payment Systems such as the dominant *Swift.* Not only is trade between Brazil and China being denominated in Renminbi but in Latin America itself, Brazil and Argentina are setting up a currency union to reduce reliance on the Dollar. "*Brazil and Argentina will this week announce that they are starting preparatory work on a common currency, in a move which could eventually create the world's second-largest currency bloc."* The last time Argentina sought to do this was in the early 1980s. It was one of the causes of the war in the Malvinas (Falklands) and it was this threat to the Dollar in the region which was decisive in winning Reagan over into supporting the British. How times have changed because of China.

Of course, the more confident foreign policy from the Chinese government and the changing allegiances of countries in Latin America, Central America, the Middle East and elsewhere is due in part to the war in Ukraine. Designed by the US to 'bait and trap' (provoke) Russia into an unwinnable war that would lead to regime change in Russia thereby exposing the northern flank of China, it has failed bloodily. The opposite has transpired. It is the West that has been shown up to be vulnerable, or in the words of Mao, the West has been exposed to be a *paper tiger*. The USA may boast about using soft power and employing Hollywood for its political ends, but it is nothing more than a bully and the Global South know this to be so, and no doubt in welcoming the diminishing of the USA will use it to their advantage.

The Dollar's rise to power the world economy.

The overall size of the American economy had surpassed the United Kingdom as early as 1872. The gap grew during the First World War. After 1914 the US became the dominant creditor nation, while the UK became a debtor nation with its debts held mainly by the US due the financial strains of WW1. In the inter-war period US exports also overtook that of Britain.

There was only one victor in World War 2, the USA. Its most dynamic competitors Japan and Germany were reduced to rubble while Britain was bankrupted by the war. One of the most startling facts highlighting this was when the UK ended up being the last country to abolish rationing in 1954. Even the defeated Germans were able to end it four years earlier in 1950. To feed Britain and pay for imports, Keynes was dispatched to Washington in 1946 to beg for a subsidy but returned only with a loan.

Our world is shaped by two forms of conflict; the class struggle (conflict between the classes) and inter-imperialist rivalries (conflict within the capitalist class). The tables were turned after WW2. Britain was reduced to a subordinate imperialist nation having been the hegemonic power 30 years earlier. By 1945, the United States was manufacturing more than half of all the produced goods in the world. US exports now made up more than one-third of total global exports, and the United States held nearly **two-thirds of the available gold reserves.**

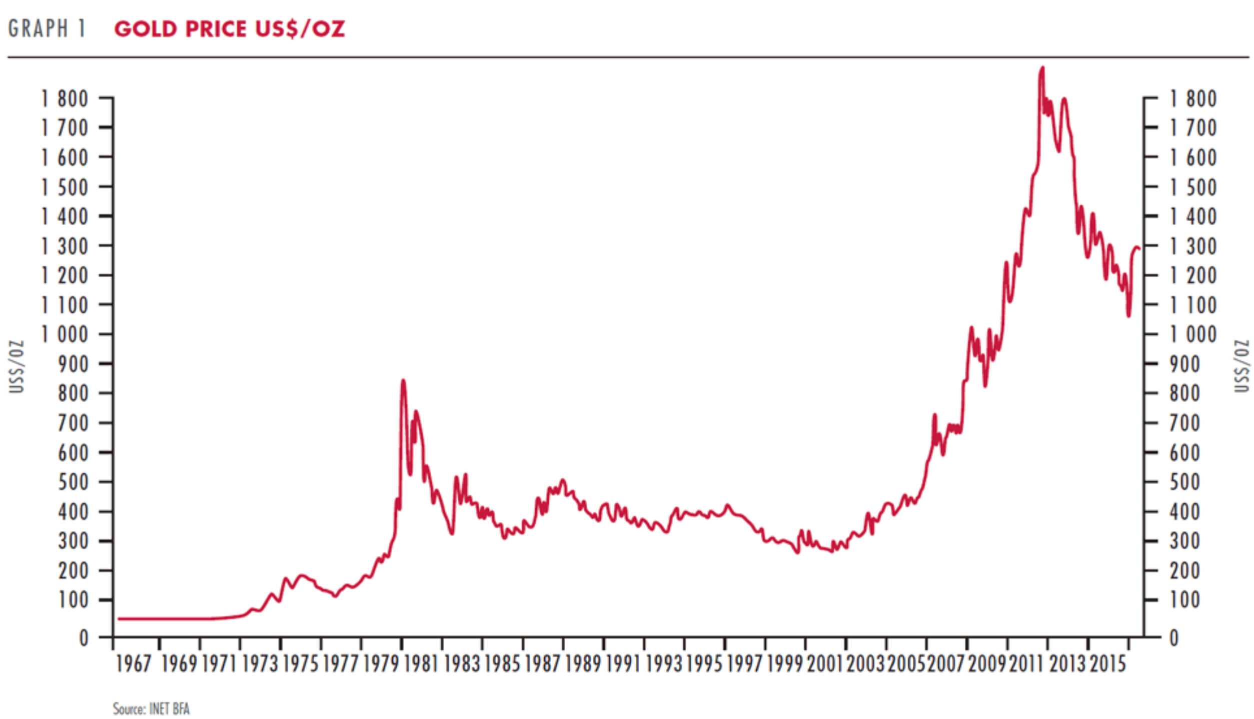
Whatever transpired at Bretton Wood, which even the USSR attended, was not going to affect the outcome. The economic facts on the ground and in vaults would dictate. The Dollar was always going to emerge paramount. Anything else was purely diplomatic subterfuge.

The only question was whether or not the Dollar needed to be tied to gold? The answer is; it need not have been. It seems this connection was a sop to the larger colonial countries like India who had suffered at the hands of foreign currencies. It ensured that the US could not engage in arbitrary devaluations or revaluations of the Dollar.

In fact the casual manner used to set the $35 exchange rate tends to substantiate this. This $35 simply mimicked the 1934 devaluation of the Dollar by the Roosevelt Administration. The $35 Dollar conversion was not arrived at through careful analysis of the actual cost of producing additional gold in 1944 which would have suggested a price higher than $35. Were it not for the sweat and blood of black mine workers in the hell holes of South African, that $35 exchange rate would have imploded well before 1971.

This [CIA report on gold production costs] is probably the best analysis of the issue of gold production after the war. It shows that most of the additional post-war gold came from South Africa. However despite the best efforts of the black mine workers and the worst efforts of their white foremen, gold reserves only increased by 20% between 1950 and 1967 compared to international trade which grew by 200%. Worse, by the second half of the 1960s an increasing number of South African mines in the *Goldfields* were becoming unprofitable. This was primarily due to the inflation in costs rather than the petering out of the best veins. Gold production increased later when the price was freed from the shackles of Bretton Woods.

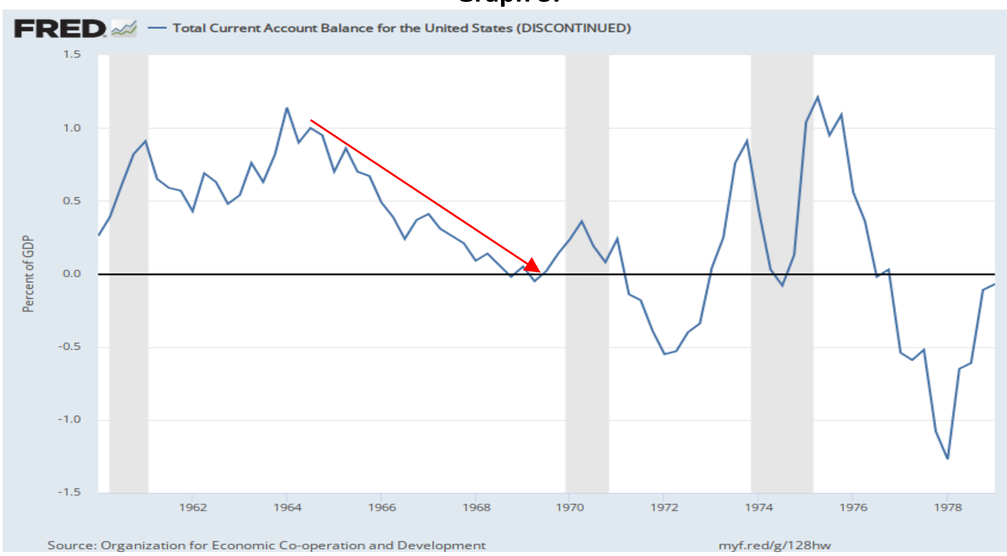
Graph 2.



The shrinking supply of new gold in an expanding world economy, made it difficult for central banks to replenish their supplies of gold and add to their stocks. It also made it difficult to use gold to settle national debts arising from the changing structure of global trade as Germany, France and Japan re-industrialised and grew their exports.

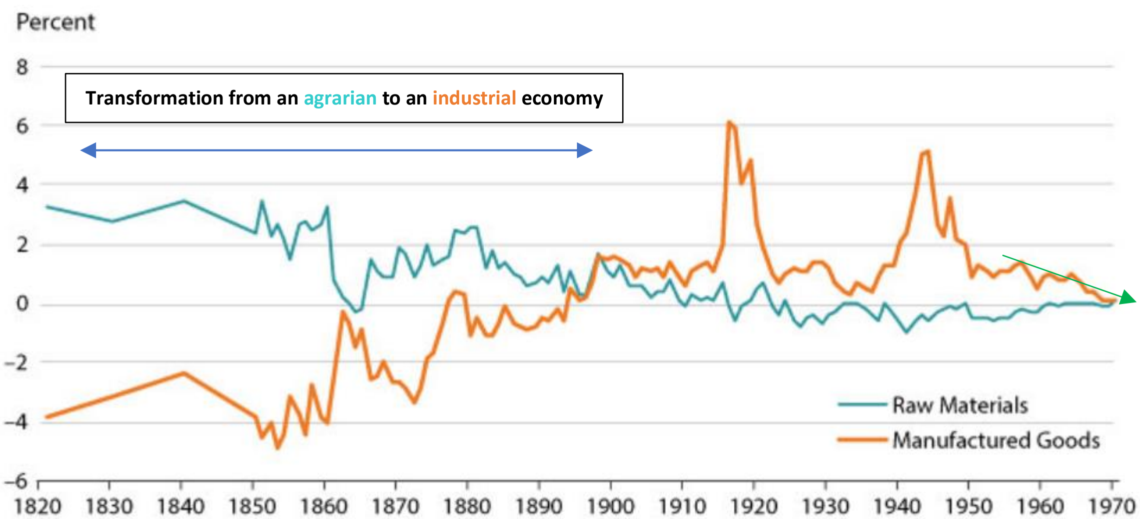
The two graphs below show this changing picture from the viewpoint of US exports.

Graph 3.



Graph 4. (From an exporter of raw material to an exporter of goods)

Figure 2
U.S. Trade Balance to GDP: Raw Materials and Manufactured Goods



NOTE: Raw materials is the sum of crude materials (e.g., coal, petroleum, and cotton) and crude foodstuffs (e.g., grains, produce, coffee, and tea). Manufactured goods is the sum of manufactured foodstuffs (e.g., meat, sugar, and prepared fruits), semi-manufactures (e.g., lumber, refined copper, and iron and steel plates), and finished manufactures (e.g., wool manufactures, automobiles and parts, and radios).
SOURCE: U.S. Census Bureau (1975), Measuring Worth, and authors' calculations.

(Source: Federal Reserve of St Louis archives)

In the first graph above based on the US Current Account which aggregates trade, service and financial flows, we see a rapid deterioration during the 1960s. Part of the reason why this occurred was due to the fall in manufactured exports during the 1960s together with the negative weight of raw material imports. The result was, aggravated by the Vietnam war, that the USA resorted to using Dollars to pay for imports rather than gold, devising ways such as Swaps to avoid paying with gold. By the mid-sixties, foreign holdings of Dollars exceeded the gold reserves held by the Federal Reserve, and by 1966, US gold reserves as a share of the global total had fallen below the critical level of 50%.

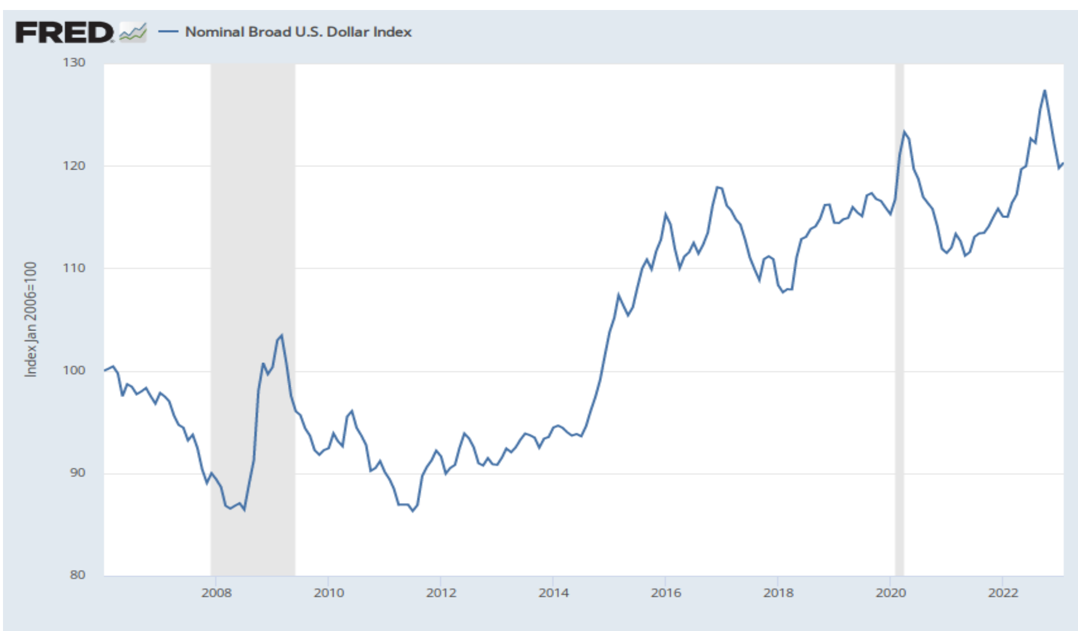
I have gone into detail on the issue of gold for the following reason. Despite the gold-addicted desire for a new international currency backed by gold, this will not happen. The problems associated with Bretton Woods shows that gold is not invariant but variant because it has an actual cost of production which changes over time due to the depreciation of state currencies and mining conditions.

And I would add, any new arrangement whose purpose will be to break the monopoly of the Dollar will be met with the same dismay at the Federal Reserve, as befell the officials at the Bank of England in 1944. "*At the time, one senior official at the Bank of England described the deal reached at Bretton Woods as 'the greatest blow to Britain next to the war', largely because it underlined the way financial power had moved from the UK to the US.* This observation was later repeated in a modified form by Churchill himself when he described it as the biggest blow suffered by the British Empire outside of War.

The current situation.

On the surface there is no Dollar crisis evident yet. At least not in the exchange rate which measures the demand for dollars. Dollar strength, despite recent softness, remains above its historical average, though below its pandemic peak when the Dollar was a sought after safe haven amidst the global panic.

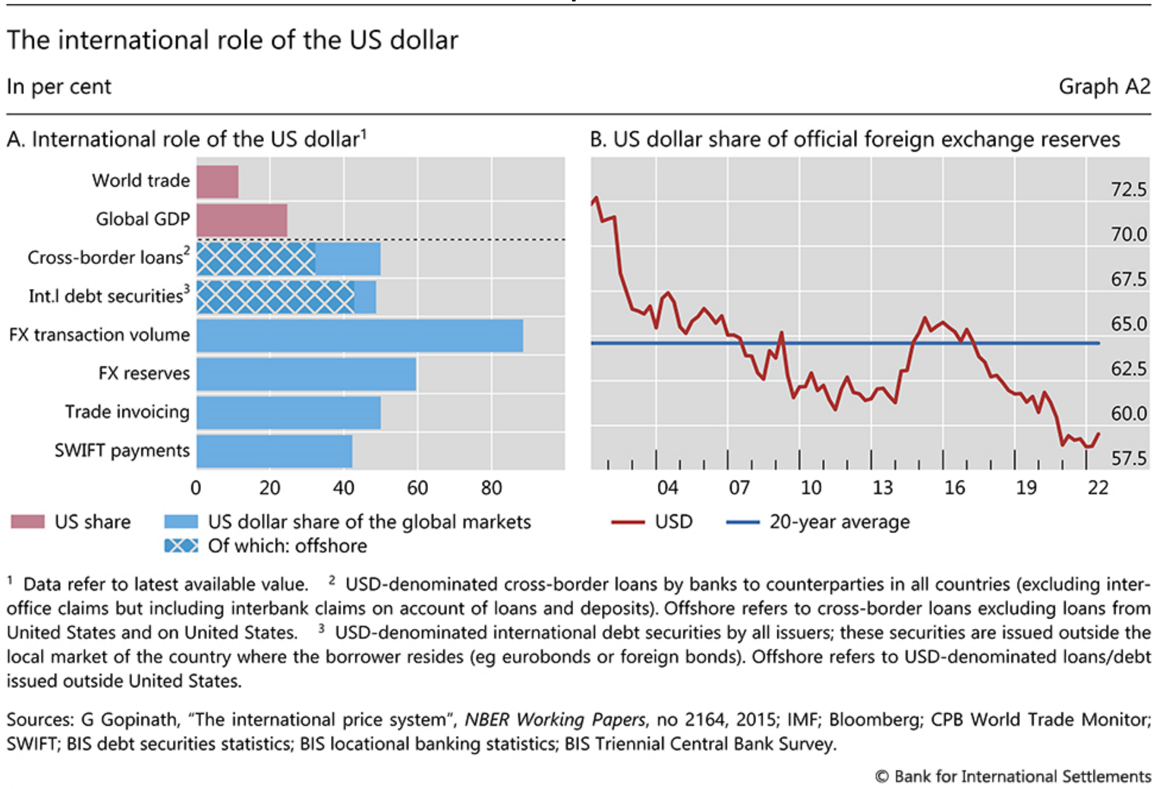
Graph 5.



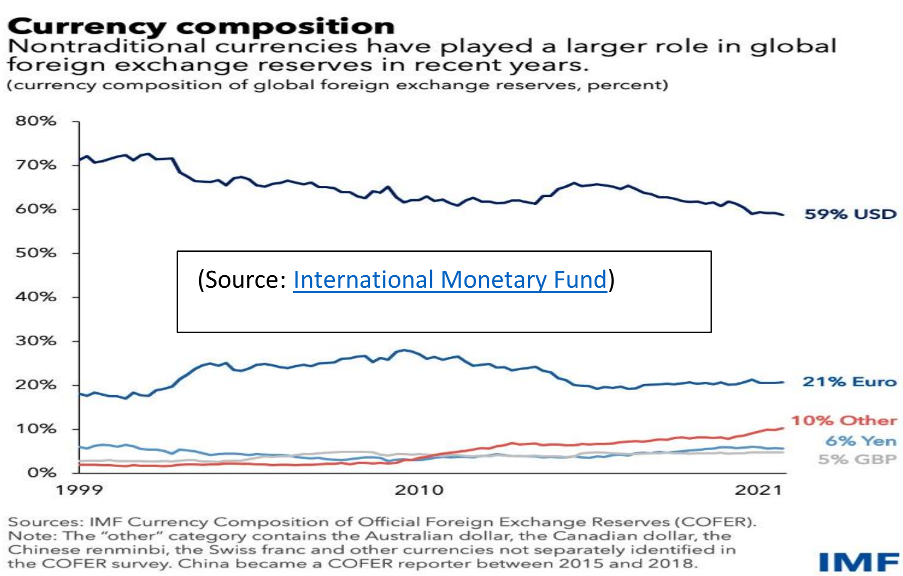
The graph below taken from the Bank of International Settlements summarises the position of the Dollar in all the important financial spheres. Generally the Dollar share of transactions and loans exceeds 40%.

The only significant decline has been in the share of foreign reserves where the portion held in Dollars has fallen from over 70% to under 60%, its lowest level in 25 years. The reason for this has not been the growth in the Euro, Yen or Sterling but 'Other' currencies which includes the Renminbi. This provides scope for alternative monetary regimes to emerge. Finally, the key level is 50%. Should the Dollar fall by another 10% to below 50% it is debatable whether its role as the world's reserve currency can be maintained.

Graph 6.



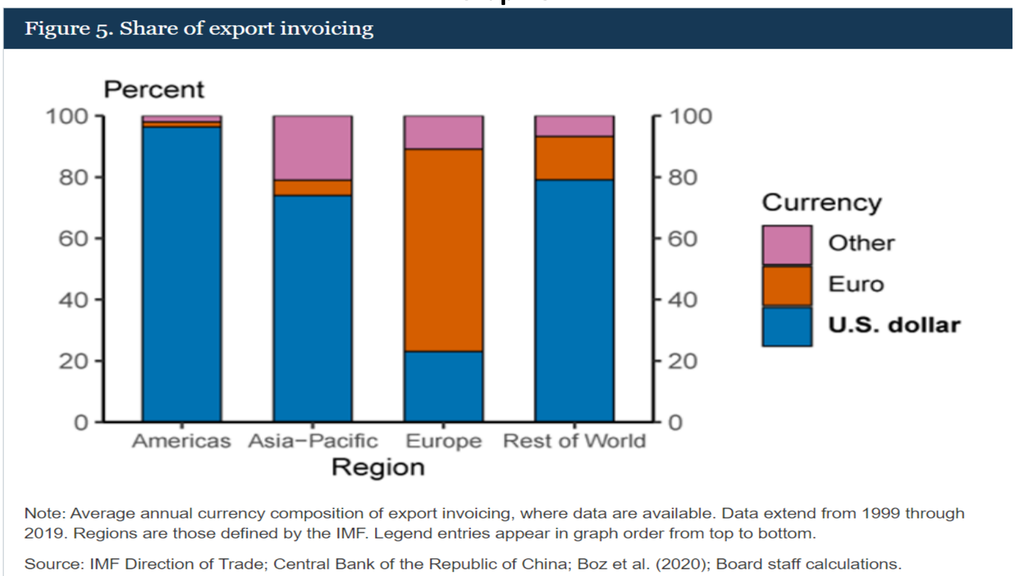
Graph 7.



(Source: International Monetary Fund)

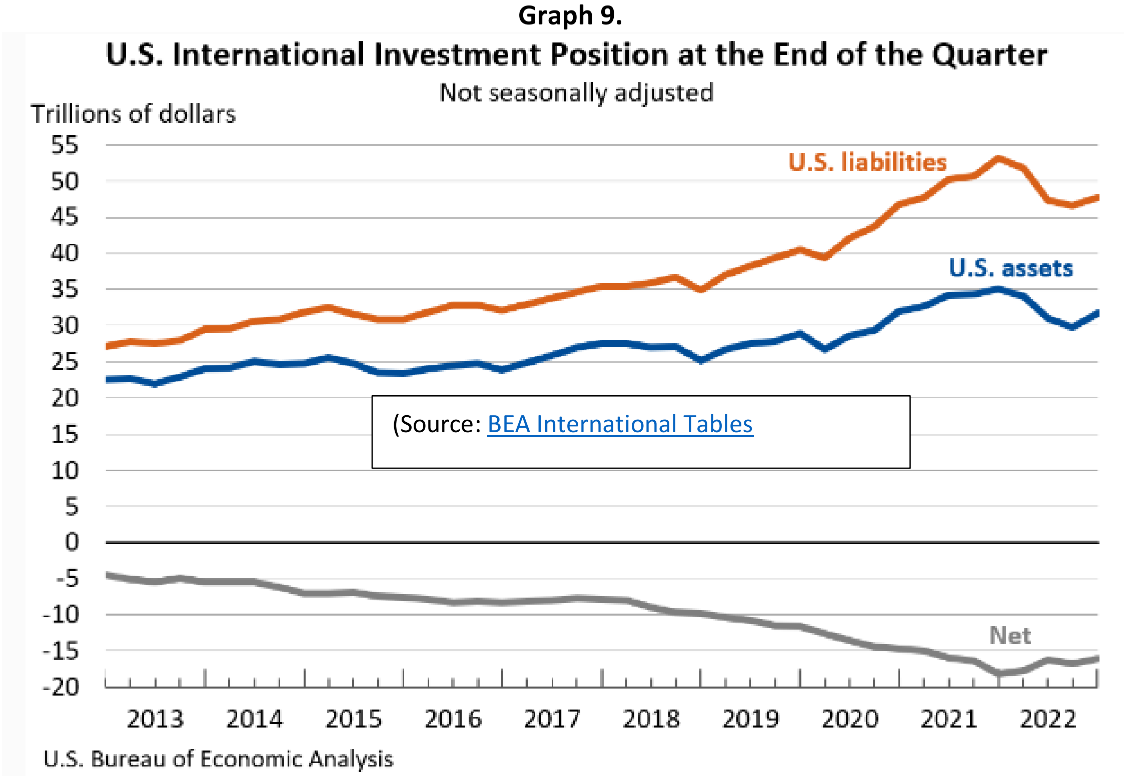
Another strength is the share of international trade which continues to be invoiced in Dollars. With the exception of Europe, the rest of the world's trade is mainly priced in Dollars. In this interesting article by the [Federal Reserve] which prepared the graph below, the FED maintains that the use of the Dollar in trade and transactions is little diminished and while it does point to China as a rising economic power it does not see any imminent challenge to the supremacy of the Dollar. But that comment is to be expected.

Graph 8.



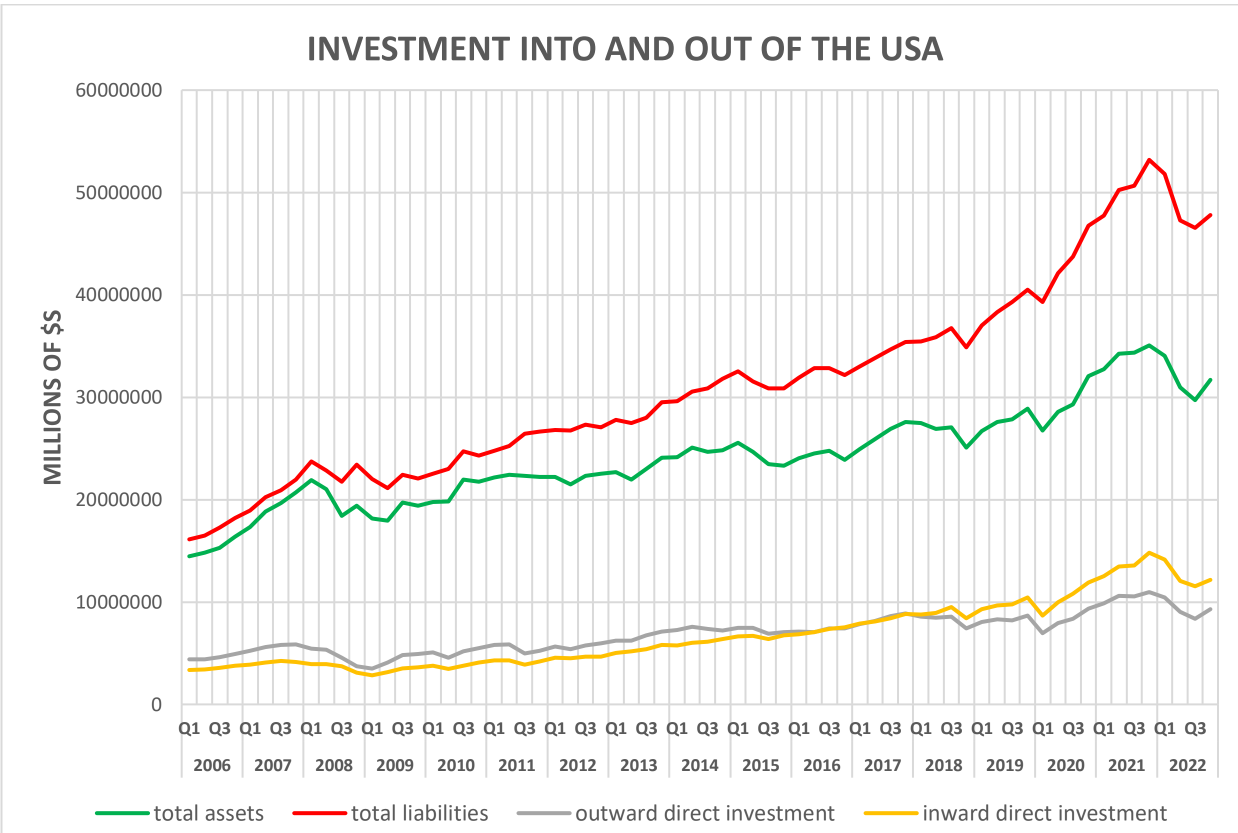
Now let us turn to latent weaknesses.

Graph 9.



The above graph is the latest quarterly summary of US foreign assets and foreign liabilities showing that the US has long since become a Debtor Nation. But it is not only its financial and portfolio flows which are deteriorating, so too the trend for direct investments (see below). Recently, direct investment into the USA has exceeded direct investment abroad. Thus if this trend continues it will reverse the flows of surplus value due to profits exported rising at the expense of profits imported. Currently, given the cumulative history of positive foreign direct investment by the USA, the income from direct investment in 2022 exceeded the income going to foreign investors by over 2:1 or $626,506 million inwards versus $293,526 outwards (but the gap is closing as can be seen in the light blue element of Graph 11.)

Graph 10. (Direct investments)



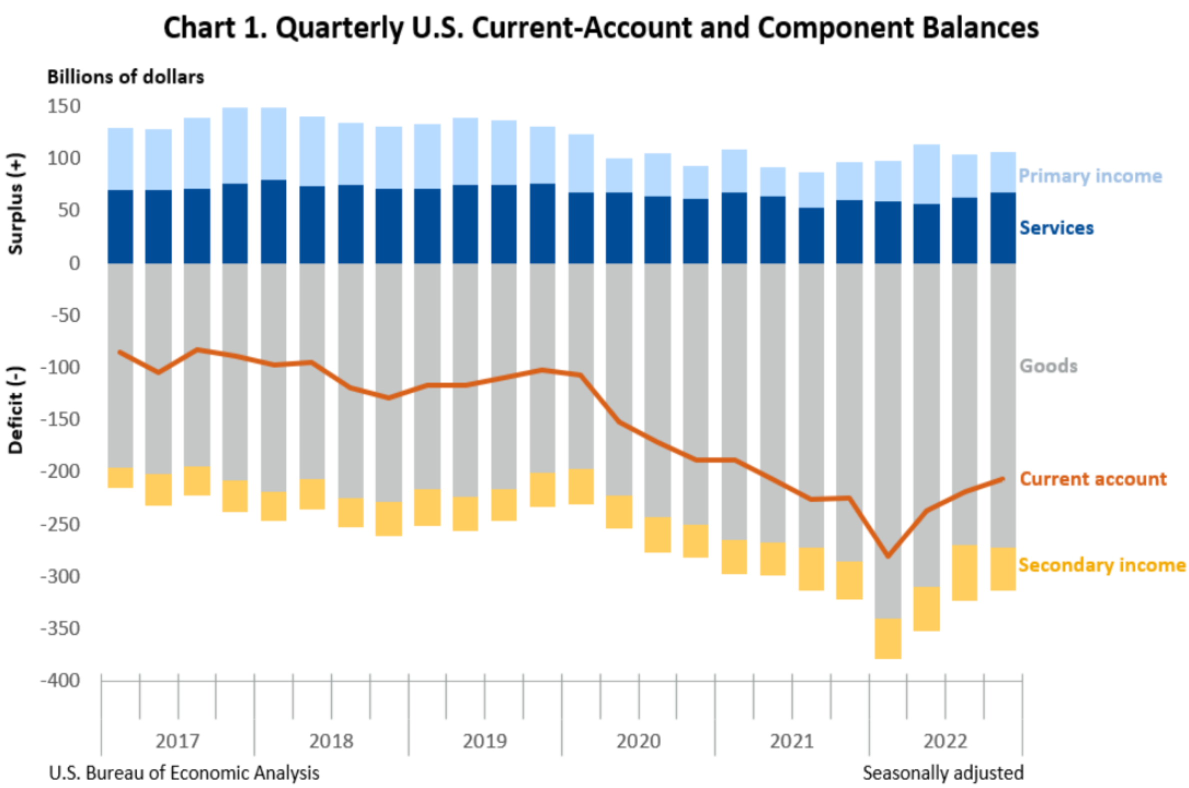
For the whole of 2022 the BEA reported that: *"The U.S. current-account deficit widened by $97.4 billion, or 11.5 percent, to $943.8 billion in 2022. The deficit was 3.7 percent of current-dollar GDP, up from 3.6 percent in 2021."* The trend can be seen in the graph below. This graph also shows the deficit in goods which swamps any surpluses on services.

However, there are a number of confounding elements associated with the imports of goods. Forty eight percent of these goods originate from US affiliates abroad, the size and scope of which we will examine shortly. This provides much opportunity to manipulate the prices of these imports. While the goods may be shipped directly to the USA, the corresponding invoices may be sent via a tax haven or two in order to lock away profits through the repricing of these invoices. In addition, there is the hidden issue of the transfer of value which boosts profit margins in the USA when this value is realised through the price of final sales. Apple Corp being a prime example.

Finally the issue of Wall Street. The US is home to less than one fifth of the world's GDP but it is home to two fifths of the world's financial or fictitious assets. Wall Street is the pre-eminent global financial centre. Given this concentration of wealth, it is clear that Wall Street and other US financial centres are a foci of demand for imported goods to satisfy the greed of the investors, banksters and speculators. Thus while their demand for goods is recorded it would be naïve to assume that all the flows of money into and out of these financial centres are recorded as in Graph 11. Many of the positive flows remain hidden.

Taking all this into account, the current account position of the USA is not so alarming. Despite this, the trend is against the USA. What all these mitigating factors can do is to slow down the trend, but they are not powerful enough to reverse it.

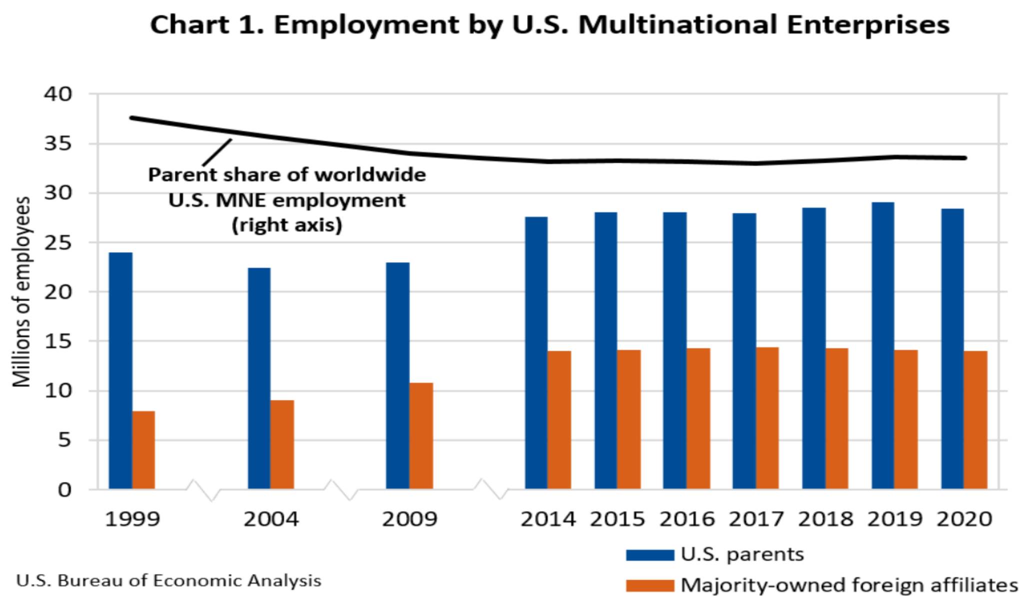
Graph 11.



(Source: BEA International Tables 1 -5)

On the next page please find the analysis of the stock of US direct investment abroad accumulated over decades. It amounts to $6.45 trillion (2019) versus inward direct investment of $4.47 trillion (2020). In terms of employment one in six workers were employed by US multi-nationals abroad (BLS data). In terms of investment the picture is even more interesting. The $1,330 billion investment abroad (Table 1; 923 + 407) amounts to 57% of the total investment by corporations within the USA itself. Put another way, 36% of all investments in the means of production are therefore made outside the USA. (We are yet to see if reshoring has any effect on these ratios.) Finally in 2019, direct investment income from abroad was equal to 27% of the corporate net surplus produced within the USA itself or 41% of after-tax corporate profits.

Graph 12.

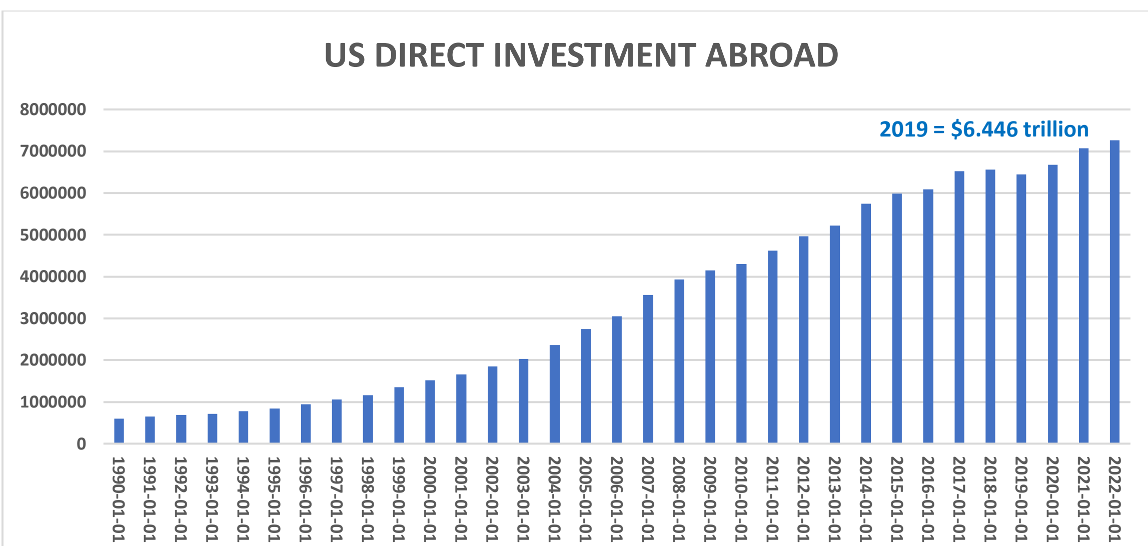


(Source: Activities of U.S. Multinational Enterprises, 2020)

Table 1 (2019 data)

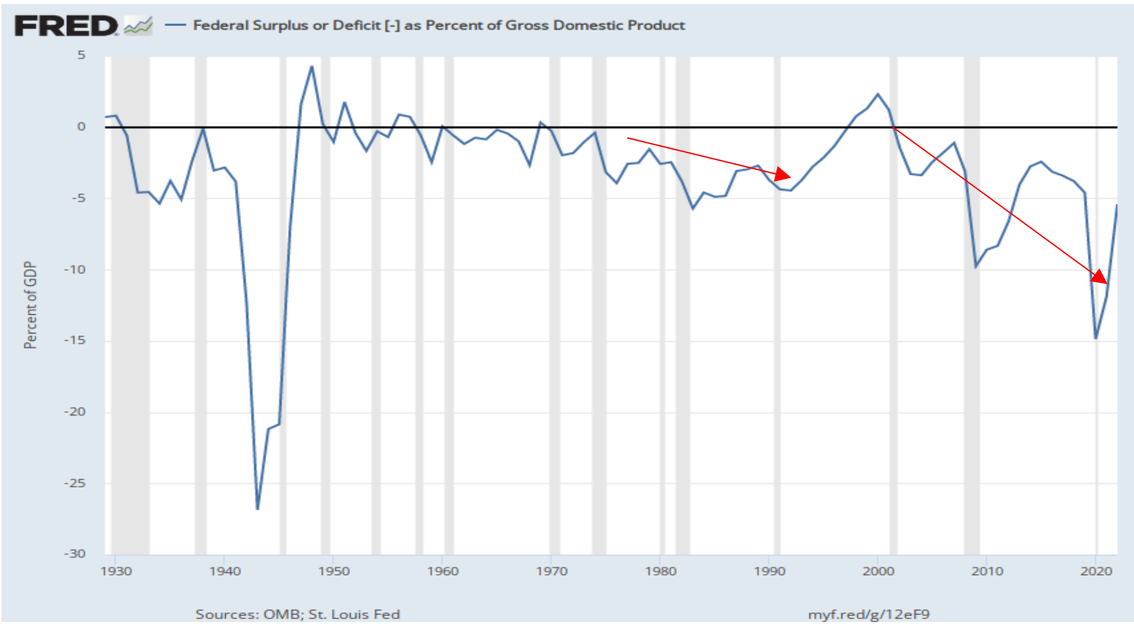
	U.S. Parents		MOFAs		
	Preliminary estimate	Revised estimate	Preliminary estimate	Revised estimate	
Number of employees (thousands)	29,297.3	29,075.7	14,610.6	14,153.8	
Value added	4,234.5	4,231.6	1,437.0	1,416.2	**=$923**
Expenditures for property, plant, and equipment	738.9	731.2	205.0	191.7	**=$407**
Research and development expenditures	350.2	349.0	58.2	58.3	

Graph 12 (the effect of globalisation).

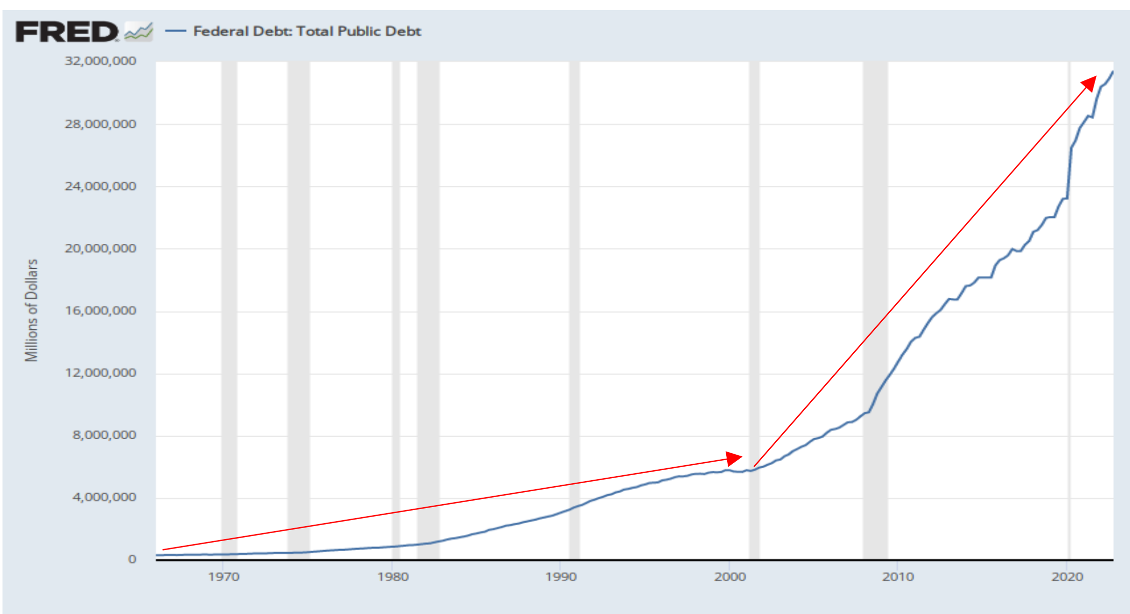


The final element which impacts the national currency is fiscal discipline. The US has very little fiscal discipline despite the continuous bickering in Congress over the *debt ceiling*. This century the deficit has grown significantly resulting in an escalating amount of public debt. In nominal terms, since 2000, the public debt has grown five-fold.

Graph 13.



Graph 14.



Currently over the first five months of this fiscal year, the deficit has increased by between 6 & 7% of GDP which is unsustainable. Clearly deficits of this order, requiring the increased issuance of Treasury Bonds, much of which is bought by foreign investors, undermines the international standing of the Dollar.

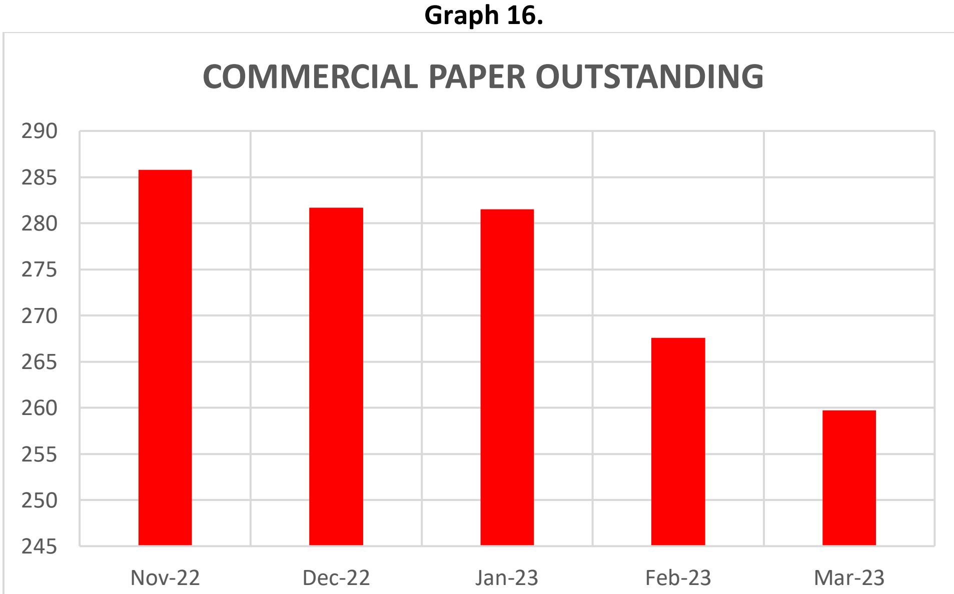
Latest developments.

March saw the first banking ructions. For the time being the FED has been able to douse it. What follows will be much more difficult to deal with and that is credit tightening. Bloomberg announced on Thursday that the first evidence of bank loan retrenchment is appearing. But even prior to the banking ructions in March, Industrial and Commercial Loans had been stagnating since November.

Graph 15.

In the case of commercial paper issuance is down 9% in March. As commercial paper has a typical term of less than 90 days, it provides a more immediate trend, thereby providing more up-to-date information.

Graph 16.



Already we can see with these two forms of bank credits which are most closely associated with turnover, that issuance is down. This is more likely to be due to the demand side rather than the supply side. However, after factoring for tighter supply because of higher lending standards since March, it can be assumed that liquidity in industry and commerce will be further impaired. Besides leading to more bankruptcies, this lack of access to bank credit on top of shrinking profit margins, will detonate the long expected forced migration of labourers from their work places.

This can be read into the ADP data on jobs released on Wednesday. The fall of nearly 100,000 well paid jobs, mainly in *Financial Activities* and *Professional & Business*, was offset by an equal rise in *Hospitality and Leisure* which is poorly paid. In terms of the total spending power by workers in the report, particularly when considering the additional fall in manufacturing employment, the fall in well paid jobs will have overwhelmed the rise in lesser paid jobs elsewhere (if they occurred).

I held back publishing this article until the Bureau of Labour Statistics released its *Employment Situation Report* in case there were any surprises. There were none as payrolls increased by 236,000 while aggregate hours fell marginally. This data is incongruous with an economy where backlogs in production have been eliminated, orders are in free-fall, and profit margins are concertinaing. Unlike the USSR capitalists do not tend to hoard workers. The only consequence of this dubious data is that given the FED is wedded to it if not welded to it, it complicates future decisions over the direction of interest rates.

Conclusion.

The USA remains the most indebted of countries. Here the exuberance of borrowing based on cheap money went the furthest. Here leverage reached new hallucinatory heights. The USA, as well as being the home to the not so brave, is also the home to the not so clever. All of this was enabled by the Dollar being the universally accepted currency. Whether it will be so when all the debts come home to roost, only time will tell.

The next three months will be a testing time for the Dollar. The discussion in the main stream financial media is no longer; *if a recession but when a recession*, and it has veered from a *soft landing* to a *hard landing*. Some analysists are even predicting a crash landing. The outlook is indeed bleak. And it's not only debt. For the first time the costs of the 1930's uprooting of supply chains by the increasingly protectionist USA is becoming apparent. The IMF now expects it to reduce global GDP by 2% p.a., clearly an underestimate. The biggest hit will be to the poorer countries caught in the cross fire. In addition, Biden's attempt to regenerate the US chip industry has hit the buffers as the key TSMC Fab project turns into a fiasco due to costs doubling in the absence of sufficiently skilled local labour.

Up to know the latent weakness of the dollar, considering all the structural problems in the US economy, has been disguised by the aggressive rise in interest rates, reaching the highest level in the G7. It is indeterminable whether or not the FED purposefully raised interest rates at this pace with the objective, inter-alia, of propping up the dollar. Clearly a strong dollar is useful for holding down import prices thereby bearing down on inflation, but whether this was part of the *dot plot* is not known.

But with inflation coming off the boil (provided the climate does not reverse this - summers of discontent) and with a recession brewing, there is unlikely to be another interest rate hike. The critical time for the Dollar is now emerging. With interest rates likely to fall sooner rather than later, the Dollar will no longer have cover.

It will be these interest rate reductions together with further external moves to de-Dollarize which will put the Dollar in the spotlight. The Dollar is about to face its greatest challenge since 1944, one which the FED and the Pentagon will not shirk from meeting. We are about to see if the decades old sneer made by US officials; "*that the dollar is our currency but your problem*" will finally reverse to become "*our inevitable problem*".

Brian Green, 7th April 2023.