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‘The Power of Currencies and Currencies of Power’, edited by Alan Wheatley

Review by Delphine Strauss

The Power of Currencies and Currencies of Power, edited by Alan Wheatley, *Routledge, RRP£9.99*

In the bitter attrition of the 19th century Peninsular War, British troops had one inestimable advantage over Napoleon’s forces: Bank of England notes were readily accepted when they bought local supplies, while French paper was treated with suspicion.

These days, only the dollar enjoys such universal recognition. The note of choice for drug dealers and war lords, it also dominates international trade and capital markets. Commodities are priced in dollars; other currencies are most often quoted, traded and at times pegged against it. This ubiquity reinforces its status as the world’s pre-eminent reserve currency: the only one that offers central banks the scale, stability and market liquidity they need to build long-term reserves they can readily deploy in times of crisis.

Economists have long debated the advantages conferred on the US by the dollar’s dominance, with Barry Eichengreen and Eswar Prasad among the latest to assess the challenge posed to it by China’s international promotion of the renminbi.

This slim collection of essays, edited by Reuters journalist Alan Wheatley, offers a readable guide to the economic debate, but its focus is geopolitical. Wheatley poses two overarching questions. How has the US used the “exorbitant privilege” conferred by the dollar’s reserve currency ranking to project its power? And will China ultimately want to bid for similar status for the renminbi, given the loss of control over exchange rate policy this would require?

Several writers argue here that the privilege for the US is far from unalloyed. Yes, the US earns seignorage – profits made by the issuer of a currency when people hold cash without earning interest – and demand for the dollar means it can issue debt and print money freely. Consequences include the US’s ability to sustain defence spending, which in turn reinforces the dollar’s appeal as a haven.

But Robert Zoellick, former World Bank president, points out in a critique of the monetary system that there are two big costs to the dollar’s international role: the fact that other countries can hold down their exchange rates by buying dollars, which damages US trade and jobs; and the moral hazard that comes when there is no pressure to adjust economic and fiscal policy as imbalances increase.

It is no longer clear that the dollar’s dominance is to the US’s overall economic advantage. However, John Williamson, former fellow of the Peterson Institute for International Economics, identifies two ways in which it adds to the US’s global influence. First, because payment in dollars ultimately involves a transfer on the books of the Federal Reserve, the US can enforce a financial blockade, as it did with Iran. Second, the sheer scale of China’s reserves – it has accumulated some $3.8tn – leaves it no alternative, in the short term, but to hold dollars: Beijing must therefore be cautious of any clash with Washington that would cut the value of its own assets.

Chafing at its reliance on US economic policies it sees as irresponsible, China has pushed to promote international use of the renminbi. It is already a serious rival to the dollar in regional trade, and central banks keen to reduce their reliance on the dollar are starting to include it in their foreign exchange reserves.

Di Dongsheng, an academic at the Renmin University of China, makes the case for Beijing to liberalise the currency further. He gives a scathing indictment of the past decade’s policy of undervaluation, arguing that the decision to favour exporters over workers has ended up subsidising global consumers and foreign investors at the expense of Chinese society.

The reforms that would be required to open China’s capital markets and fully liberalise the renminbi would give consumers a bigger share of the economy and support living standards. Yet there are also risks: of greater economic volatility and also of foreign policy complications. His essay is a salutary reminder that there is no consensus yet in China on the merits of making the renminbi a leading reserve currency. But even with Beijing’s backing, its rise would be slow and uncertain. And other outcomes are possible: as Mr Zoellick states, the current system of floating exchange rates “is not immutable”.

Frustrations with the dollar’s dominance are growing. The global fallout from the Federal Reserve’s stimulus policies, followed by Washington’s willingness to take budget talks to the brink of default last year, have made many governments reassess their reliance on US economic policy.

There is a general wish to stop the dollar being, as Richard Nixon’s Treasury secretary once told anxious Europeans, “our currency, your problem”. But it is far from clear what the alternative will be.

The writer is the Financial Times’s currencies correspondent

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