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# How Trump Could Fatally Weaken the Dollar

When the president undermines the rule of law and the independence of institutions like the Fed, he threatens a pillar of American economic strength.

**By Eswar Prasad**

Mr. Prasad is the author of “The Dollar Trap: How the U.S. Dollar Tightened Its Grip on Global Finance.”

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The United States dollar seems to be under threat from multiple quarters. Countries that have been hit by American sanctions, such as Iran and Russia, economic rivals like China, and even allies in the European Union want to shake off the dollar’s tight grip on global finance.

For now, they are out of luck. The American economy and financial markets are the largest in the world, and there are no good alternatives.

In the long run, however, the rest of the world might get its wish. The dollar’s status as the dominant global reserve currency is the result of faith in America’s strong institutions. This includes the checks and balances among different arms of government, the rule of law and an independent central bank. These institutions have proved durable and earned the trust of global investors, who see the dollar as a safe haven in troubled times. But President Trump and his acolytes are undermining those very institutions with their words and actions.

Other countries have long chafed at the dollar’s dominance in global finance. Nearly two-thirds of the foreign exchange reserves held by the world’s central banks’, essentially their rainy-day funds, are held in dollars. It is the currency used to denominate and settle a significant part of international financial

transactions. Almost all commodity contracts, including those for oil, are priced and settled in dollars.

This gives the United States a lot of power. Since dollar transactions usually involve the American banking system, the United States government can put a chokehold on countries like Iran and Russia by limiting their access to global finance.

Emerging markets' fortunes remain tied to the dollar. In the aftermath of the financial crisis, when interest rates in the United States fell toward zero, investors looking for higher yields poured money into emerging markets, causing sharp increases in stock prices and inflation. When the Fed started raising interest rates, capital quickly fled. Countries such as Turkey, India and South Africa, which have borrowed extensively in dollars, face another problem. When American interest rates rise and the dollar strengthens, their debt burden becomes worse.

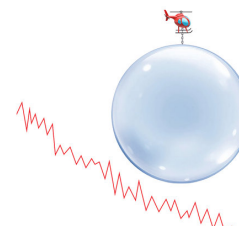
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Emerging markets are keen to shift away from a dollar-dependent global financial system so they are not subject to the spillover effects of the Fed's actions. China and Russia are setting up their own payment systems to lessen their dependence on American banks. Eurozone officials are eager to do the same so their banks are not held hostage, as they see it, by regulators in the United States.

In the past, none of this would have made a dent in the dollar's dominance. No other country has the unmatched combination of size, trust and influence

enjoyed by the United States. The global ripple effects of last week's stock market fluctuations were a clear illustration.

But the Trump administration, and its allies in Congress, are wreaking havoc on the institutions that have made the dollar dominant for so long.

Republicans in Congress have abrogated their role to act as a check on the powers of the President. They have merrily gone along with harmful economic policies, including tax cuts that will add at least \$1 trillion to government debt when the economy is doing well and needs no help from the government. And they have willingly accepted weakening of regulation on banks and other parts of the economy, raising the risks of financial market problems in the future.

The rule of law is being eviscerated by an administration that is openly venal and sees itself as above the law. And stacking the courts with judges who are chosen for their willingness to advance a particular agenda is eroding confidence in the judicial system.

Finally, Mr. Trump's open attacks on the Federal Reserve could hurt its credibility. Households, firms and investors trust the Fed to do what's necessary to manage inflation, even if that means taking politically unpopular decisions such as raising interest rates when the economy is growing fast. When the president says that the Fed is "crazy" and "out of control" or comments that he is "not happy" or "disappointed" with the Fed's rate decisions, he could cause irreparable damage. Investors' confidence in the Fed as an institution that is unmoved by shifting political winds is essential to keeping the dollar strong.

The dollar's dominance may outlast the Trump era, but it is not inevitable. If the president continues to hack away at America's institutions, the dollar, too, will suffer. This might end up becoming one of the biggest scars the administration leaves on the American economy.

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