

Barry Eichengreen on the End of the Dollar

By Dan Richards

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Barry Eichengreen is a professor of economics and political science at the University of California, Berkeley and a former senior advisor to the International Monetary Fund. He has researched, and published widely on, the history and current operation of the international monetary and financial system.



Dan Richards spoke with Eichengreen at the annual meeting of the American Economic Association in Chicago in early January.

A video of this interview is available [here](#).

I'd like to talk about two of your recent articles – [Europe's Darkness at Noon](#) and [Disaster Can Wait](#). They covered your outlook for the Eurozone in 2012. What is your view today?

I've been following the Eurozone project and the euro for a long time. A lot of my American friends accuse me of having gone native – having drunk the Kool-Aid – for believing that the Europeans can make this work. I continue to think that that is the case. Saving the euro will be enormously expensive, but not saving it will be even more expensive.

When European leaders confront that fact, and they have begun to, and more importantly when they get their publics to understand that and not to simply view the euro crisis as a morality play involving thrifty Germans and spendthrift Greeks, they will take the hard measures needed to save the euro.

So 2012 will see more pressure on leaders and publics to recognize that and respond. I continue to hope against hope that that's what they'll do.

In *Darkness at Noon*, you start from the notion that as black and as dire as things look now, there is the potential for a positive outcome in sight. But you don't subscribe to the view that 2012 will see dramatic fiscal integration in Europe, which is one of the arguments that euro optimists make.

Jean-Claude Trichet, the former president of the European Central Bank, talked about a quantum leap in European integration last year. He was thinking about euro bonds, backed by the full faith and credit of all EU members' common budget. Those things will come, but they won't come in 2012. It will take time to get there.



There are 27 EU members that all have to agree. Some of them, like the Irish, will have to agree in public referenda. Not all the referenda will pass the first time. It will be a long, complicated process. What we will see in 2012 is an effort to deal with the immediate problem in the context of existing institutions. After that, they will work on the ongoing problem of fiscal integration and political integration. That is what German Chancellor Angela Merkel has basically said; this is a multi-year problem of institutional reform. That's unavoidable.

One question that arises is whether the political leadership has sufficient time. If it is a multi-year project as you suggest, what about the contagion that we're facing in Greece, Portugal and Ireland? The consensus is that those economies are small enough in scale relative to Europe as a whole that they can be contained. But if Spain and Italy run into substantial problems, and their borrowing rates escalate, will that be more problematic?

As we speak here today, Italy has run into those problems. Italy is paying over 7% on its 10-year bonds. It is an economy whose nominal growth rate, real growth plus inflation, is on the order of 2% at best. That is not a sustainable situation. Italy only has to renew or roll over about a fifth of its debt this year, so the hit to its budget is containable, but what it means is that the Europeans have a window of a year or so to solve those problems, to restore confidence in the European economy, in the Italian economy and its finances, and critically, to begin to grow again.

So, to my mind, there are two big problems in Europe. One has been solved – the banking problem – because the European Central bank has committed to provide liquidity for as long as three years to the banks. Number two is the growth problem, and that one hasn't been solved. Italy and Spain and the others need to grow in order to pay their debts and maintain political support for economic reform. That growth is not on the horizon yet. The forecasters tell us that Europe should have a mild and short recession in 2012, but unfortunately the forecasters are not always right.

Last year you published a book, *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*. You are delivering a talk on moving to a multiple-reserve-currency system. What is happening to the role of the US dollar as the reserve currency?

One of the points I wanted to make in the book is that we still live in a remarkably dollar-centric world. The dollar is still used in 85% of all foreign-exchange transactions worldwide. It still accounts for nearly two-thirds of all of the foreign-currency reserves of central banks and governments around the world.

People talk about how the euro one day may rival the dollar, assuming it survives. They talk about how China's currency may one day rival the dollar.



They are right, but that is a discussion about the future.

For the time being, financial markets revolve around the dollar. Even when there are shocks to those markets that are created by the United States, like the debate over the debt ceiling last summer and the downgrade of US Treasury debt by Standard & Poor's, investors rush into dollars as a safe haven rather than rushing out.

So that is the "rise" in the title of your book. Let's talk about the "fall." What do you anticipate?

The dollar became the dominant global currency in the second half of the 20th century for good reasons. The United States was far and away the dominant creating-and-producing nation. Only the United States had deep and liquid financial markets open to the rest of the world, but that is no longer true now. The US accounts for something on the order of 20% of the global economy, and increasingly there are other advanced and emerging markets that have opened their financial sectors to foreign investors. We can expect that to continue. Other parts of the world will be growing faster than the United States, which is a mature economy.

Ten years from now, China's currency, the renminbi, will be an attractive vehicle for settling import and export trade, in Asia especially, and for doing a variety of international financial transactions. If you look out another ten years, people will be thinking about using Brazil's currency or India's currency.

Do you visualize another currency, such as the Chinese renminbi, replacing the dollar, or do you see moving more toward a basket of currencies as the global reserve currency?

I see moving toward a basket. In the past, many people argued there was only room in the world for one true global currency. If it was convenient for other people to use dollars, you had no choice but to use dollars as well, like we are both speaking English even though we come from different countries.

The world is changing; just like in discourse, where more and more people are bilingual. In financial affairs, it becomes easier to compare prices denominated in different currencies. Once upon a time, if you wanted to break into global markets with your exports, you had to price them in dollars so people could figure out whether they were competitive. Now everybody has a smart phone in their pocket that can be used to compare currency values. We are moving toward a multiple-currency world.

When you think about that multiple-currency world, do you anticipate a synthesized currency unit that will combine the different components of multiple currencies?



No, I don't think so. A global Central bank needs to take on global responsibilities when there is a need for emergency liquidity. Right now, people need dollars and they turn to the Fed to get those dollars. Ten years from now, they will probably turn to the Fed and the European Central bank and the People's Bank of China to get their respective currencies.

But the kind of synthetic unit you describe might be created by, say, the International Monetary Fund. The IMF has an accounting unit called Special Drawing Rights (SDRs) that is a proto-global currency. For that to become widely used and accepted, the fund would have to have the powers of a global central bank. It would have to have the power to issue more SDRs overnight on its own volition. Because we have no global government, we are not going to have a global central bank anytime soon, and therefore, we are not going to have a composite global currency.

The scenario you described is plausible given the rise in power of other economic units in the world. What are the implications for the US of no longer being the sole reserve currency and instead being just one of the reserve currencies? One of the reasons that interest rates have been as low as they are is because of that reserve currency status. Will interest rates in the US increase closer to those around the world as a result?

Yes, that's right. The best empirical estimates I've seen suggest that. In the period before the subprime crisis in the first half of the last decade, the US 10-year Treasury bond rates were as much as a full percentage point lower than they would've been otherwise, because foreign central banks wanted to acquire dollars, and they were willing to lend to the United States in effect at lower interest rates than before the subprime crisis.

That suggests that low interest rates can be a mixed blessing. If you are borrowing for sound purposes, you can borrow more cheaply and more extensively. If you are engaged in real-estate speculation, with higher interest rates the United States is going to be better off in the sense that it will feel financial discipline earlier and more regularly. So the US is going to have to pay its way. We are not going to be able to export green pieces of paper in order to import flat screen TVs. But on the other hand, it will make the world a safer financial place.

You are delivering a talk at this conference on the reform of the International Monetary Fund, which you call an unfinished agenda. Can you provide the backdrop to that talk?

The IMF is – how should one put it politely – a work in progress. It has evolved over time, and now it is working with a group of 20 countries to try to put some structure on the operation of the international financial markets and the global economy.

The fund essentially faces three challenges. Number one, it is engaged in surveillance, trying to identify economic problems where they threaten global economic and financial



stability, and it hasn't always done a good job. Number two, it must respond to those problems through emergency lending and other means when they are detected. Again, it hasn't always carried out that function as well as it might. And number three, it has to regain the confidence of its members, partly by improving its operations and partly by improving its own governance, so that rapidly growing countries are better represented there.

There have been criticisms of some of the moves that the IMF enforced in terms of austerity when developing countries ran into debt problems. Are you thinking about that as well?

The current example of that is ironically not in a developing country, but in Greece, where a very severe economic crisis required outside intervention. The IMF became the indispensable agent for intervening. The European Union and Greece's EU partners couldn't negotiate tough conditions, and couldn't reach an agreement with the Greek government about what kind of difficult steps they would take in return for outside financial assistance. So they had to turn to the fund.

Greece is a case where it is clear that painful cuts have to be put in place, and that the Greek government has been living way beyond its means. The problem though is that the same medicine was applied elsewhere in other countries that have turned to the IMF for assistance, including Portugal and Ireland. A valid criticism of the fund has been that in the past that it hasn't varied its advice sufficiently with circumstances. It has always gone to the same playbook, and there is some evidence of that problem still today.

For the IMF to make a significant change in its approach and in its process and philosophy, it presumably depends on the key members of the IMF buying into that. We saw a change in leadership at the IMF last year with Christine Lagarde, formerly the finance minister in France, taking on the role as the head of the IMF. Do you have the sense that there is an appetite among the leading developed countries which have historically been the principal funders of the IMF for that kind of dramatic change?

It's hard to generalize about the leading countries. They understand that the IMF has to change with circumstances, and learn from its mistakes. The last couple of managing directors of the fund, not only Mrs. Lagarde, but Dominique Strauss-Kahn as well, have both been intellectually flexible, and they have succeeded finally in moving the IMF into the 21st century.

In addition, the fund is doing a couple of other things that I'm aware of. Number one, they have an independent evaluation office where people independent of the fund and some internal folks who are independent of operations evaluate what has worked and what hasn't. In addition to that, they are trying to become more diverse in terms of what kind of people they hire.



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