Will US Dollar ever loose it's Kingpin Status?

Written by : Nazir Ahmed Shaikh

At the conclusion of the Islamic summit in Malaysia, Prime Minister Mahathir Mohamad praised Iran and Qatar for withstanding economic embargoes and said it was important for the Muslim world to be self-reliant to face future threats. He said "With the world witnessing nations making unilateral decisions to impose such punitive measures, Malaysia and other nations must always bear in mind that it can be imposed against any of us".

Iran, Malaysia, Turkey and Qatar are considering trading among themselves in gold and through a barter system as a hedge against any future economic sanctions on them.

Prime Minister Mahathir said "I have suggested that we re-visit the idea of trading using the gold dinar and barter trade among us." He was referring to the Islamic medieval gold coin. "We are seriously looking into this and we hope that we will be able to find a mechanism to put it into effect."

In 1776, Adam Smith, described barter trade as primitive in his seminal "The Wealth of Nations" book. Before the invention of money (coin or paper) there was barter trading, a form of exchange without the use of a monetary medium such as coinage, paper money, or electronic cash.

Since the 2008 global financial crisis, there has been an increase in barter trade by many countries. The possible reasons could be:

- They were heavily indebted with insufficient foreign reserves
- Effected by the sanctions imposed by U.S. (for example Iran, North Korea, Russia, etc.)
- To avoid the use of dollars in local, regional and international trade
- Interested in reducing current account and trade deficits

With growing resistance to use US dollar, in international trade, by China, Russia, Turkey, Venezuela, Iran, North Korea, and Cuba; how much longer can the US dollar keep its "Kingpin" currency status? The quick rise of Chinese economy and constant threat of Russia will challenge the dollar dominance, and maybe the latest theatrical trade war between the United States and China is the best or only response the U.S. was able to come up with.

The U.S. endeavor in becoming the world's most dominant nation is easier said than done. American Revolution War (1775-83) was the defining moment in US history. While the Revolutionary war was in full swing, the Continental Congress authorized the issuance of Continental paper notes in 1775 to finance the war, and declared its independence from the

Great Britain on July 4, 1776. This marked an era during which feudalism left its place to capitalism which was fueled by the Industrial Revolution in the 18th and 19th centuries.

Before the Italian explorer Christopher Columbus discovered America in 1492, there were already people on the continent (i.e. Native Americans) who used barter as well as animal skin and wampum or white shell beads as a medium to exchange goods. Strange enough, even the name of the U.S. monetary unit “dollar” was derived from a non-English word “thaler”18 which was the short name for the first silver coins minted in 1519 in Joachimsthal; as part of the silver standard, coins were used during 16th – 18th centuries by nations in different continents, they were also called “silver dollar” . The U.S. dollar was not even in circulation until the late 18th century (1792), plus the dollar as an international currency was only established in the post-WWII.

A shortage of the British coinage in North America forced its 13 colonies to use a variety of substitutes that included privately issued paper money. However between 1723 and 1760, excessive quantities of paper money caused hyperinflation. Consequently, the British government steadily restricted the rights of few colonies to issue paper money; but the ban later was extended to all colonies in 1764. The dispute by the British government over notes was argued to be one of the primary causes of the American Revolution War (1775-83). While the Revolutionary war was in full swing, the Continental Congress authorized the issuance of Continental paper notes in 1775 to finance the Revolutionary war and declared its independence from the Great Britain on July 4, 1776. Unfortunately, Continental paper money was redeemed at a significant discount; by 1778, they were only worth as low as 1/7 of the original face value which later devalued at 1/40 by 1780, and then their circulation was seized permanently in year 1781

The silver standard was in effect for about four hundred years, from the first minted thaler coins in 1519 to 1900 when the U.S. officially accepted the gold standard. The silver content and weight of silver coins under the silver standard were varied across countries and continents21, for instance the U.S. silver dollar weighed slightly lighter; 26.73 gr. as opposed to 29.2 gr. The U.S. adopted the silver standard in 1785 but from 1860 to 1871 there were attempts to create a bimetallic standard for the US dollar. The U.S. Congress passed the Coinage Act of 1834 to adjust the silver to gold ratio from 15:1 to 16:1, this move made the U.S. gold cheaper than the world market price. As a consequence, the U.S. exported silver therefore silver coins in circulation diminished in 1873-1900; however, the influx of silver led to the issuance of silver certificates during 1878-1963.

Although the United States was on a bimetallic standard, the US Coinage Act of 1834 fixed the value of the dollar at $20.67 per ounce of gold. In order to finance the Civil War (1861-65), the US Congress authorized the issuance of fiat money (i.e. dollar) without convertibility to silver, gold, or any other metal with intrinsic value. In 1873 the U.S. abandoned the silver standard and embraced the gold standard. Officially, the U.S. accepted the gold standard in 1900; nevertheless, the classical gold standard (1900-1913) was interrupted by the outbreak of WWI

(1914-18), causing many countries in Europe to suspend or abandon it; Germany went off the gold standard in 1914.

The seeds of the American primacy and the dollar's monetary hegemony was planted at the 1944 Bretton Woods Conference where the value of the dollar was set at $35 per ounce of gold. Two events were crucial in dollar's path to becoming the world's main reserve currency; first, the dollar's main competition pound sterling was eliminated when Maynard Keynes ridded the UK of the reserve currency status and its imperial grandeur or preference. Secondly, runs on gold stemming from speculative attacks in 1971 drained the U.S. gold stock and the dollar was devalued to $42.22 per ounce of gold. Subsequently, President Nixon was prompted to terminate the dollar's link to gold.

With the sudden collapse of the Bretton Woods system of fixed exchange rates pegged to the dollar, the United States became the world's central bank to provide global liquidity. The bad news was that the negative side effects of the Bretton Woods' failure coupled with unfolding macroeconomic events rattled markets worldwide in the early 1970s. Keynesian economics lost influence due in large part to stagflation and very high inflation in many countries despite interventions by their governments. Besides the failure of Germany's Herstatt Bank in 1974 OPEC sharply raised the oil prices in 1973 as a retaliation to the U.S. for its aid to Israel during the Arab-Israeli conflict.

Economic theories in the late 18th century through the mid-19th century had contributed to the fast evolution of the U.S. dollar and its remarkable transformation in becoming the world's main reserve currency. With the help of classical economic theory, people under a monarch rule (i.e. feudalism) were motivated to become consumers in the newly transitioned capitalistic democracies where markets were left to self-regulation (laissez-faire); further, classical economists advocated no government intervention, a practice that was associated with meritocracies. Keynesian economists refute many notions of the classical economics; as such, supply-side economy, no government intervention, self-regulation, low wages and full employment, and natural state of equilibrium Keynes advocates government intervention (i.e. countercyclical policies), and argues that economies tend to expand and contract (i.e. boom-bust-cycles) and may not return to a natural state of equilibrium.

According to monetarists, supply of money is at the center of economic growth, and monetary policy is used by central banks to reduce or contract the aggregate money supply. The United States' abuse of sanction power in recent years together with the rise of Chinese economy i.e. as of 2014, China passed the US as the largest economy in PPP (purchasing power parity). So the wishful economists have actually begun to believe that the dollar's days are numbered. In this millennium alone, US has imposed as many as 60 sanctions on 35 countries (i.e. Russia, Iran, Sudan, Venezuela, North Korea, Cuba, China, Qatar, etc.). However, many economists and historians believe that sanctions in most instances are counterproductive and damaging for the economies of all nations involved. For the past two decades, sanctions imposed on Iran and North Korea have proved to be non-deterrent in the behavioral change of offenders.

Modern gold rush generates new hopes to end US dollar dominance. Since the Asian crisis in late 1990s and China and Russia and now Turkey in recent years have been aggressively accumulating gold reserves to mitigate potential adverse effects of the US dollar. As of fourth quarter 2019, Russia had massive gold reserves of 2241.86 ton and China's 1,770 ton.

Banking panics, unresolved global imbalances, excessive risk-taking by international banks, distorted incentives, accommodative monetary policies and the propagation of systemic banking crises mostly triggered by too-big-to-fail financial institutions and the consequent financial dismay left behind were a compelling reason behind the emergence of cryptocurrencies. Advocates believe that Bitcoin will dominate as a medium of exchange online, end the dollar's hegemony, and become a global reserve currency.

How much longer can the US dollar keep its "kingpin" currency status? According to economist Jim O'Neill, not very long.

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