

Opinion **US Dollar**

America beware: dollar supremacy is not forever

Under Trump, the US is increasingly seen as an unreliable partner

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'Trust in US institutions is why the dollar remains strong, but this strength could prove fleeting' © Getty
Eswar Prasad MAY 20, 2018

The [dollar](#) reigns supreme in global finance. It accounts for a dominant share of international financial transactions and is the ultimate safe haven currency. But the US currency's supremacy cannot be taken for granted. President Donald Trump may be sowing the seeds of its demise.

Mr Trump has often called for a [weaker dollar](#), apparently to counter other countries that he claims are taking unfair advantage of the US by weakening their currencies to boost exports. Talk is cheap, however, and such statements by themselves will hardly derail the dollar. The real damage to its standing is more insidious and comes from policies that are eroding America's fiscal stability, its trustworthiness and the strength of its institutions.

In times of financial turmoil — including the global financial crisis, which originated in the US — panicky investors flood into US bond markets. No doubt the sheer size of the American government and corporate bond markets is a key factor. But there is something subtler and more important that accounts for the dollar's status.

It comes down to trust. Flows into and out of currency and equity markets, where people make consequential financial decisions, show how trust matters even in seemingly cold-hearted and dispassionate decision-making.

The institutions that engender and maintain the trust of both domestic and foreign investors include an open and transparent system of democratic government with checks and balances. This needs to be underpinned by a central bank free from direct political interference and the rule of law administered by an independent judiciary.

Trust in US institutions is why, despite the prospect of rising government debt levels and the [economic uncertainty](#) unleashed by Mr Trump, the dollar remains strong. But this strength could prove fleeting. At present, most international financial transactions are denominated and settled in dollars and often through American financial institutions. This would change rapidly if investors believed that reckless fiscal policies could heighten volatility and erode the dollar's value.

As it is, the falling cost of transacting in other currencies and the rise of emerging market currencies such as [China's renminbi](#) are already reducing the dollar's role in denominating and settling cross-border transactions. China and South Korea are conducting trade using their own currencies rather than relying on the dollar as a "vehicle currency". The logic for denominating in dollars virtually all contracts for oil and other commodities is waning.

Other forces are at work. Under Mr Trump, the US is increasingly seen as an [unreliable partner](#) in trade, military and other agreements. This has damaged its international credibility and also sown fear that Mr Trump could wield the dollar as a weapon of control over other countries. Consequently, China and Russia, among others, are setting up their own payment systems and channels that bypass the US.

Perhaps, even if the dollar wanes as the dominant medium of exchange, it will remain unparalleled as a safe haven. Foreign investors, including central banks, have shown no signs of forsaking their dollar assets.

US institutions have indeed withstood the test of time, but taking them for granted could prove costly. When the American political system has come under severe stress in the past, a free press, backed by an independent judiciary, has functioned as a correcting mechanism. All of these institutions are under attack from Mr Trump, abetted by a Republican-dominated Congress.

The dollar's supremacy depends not just on America's economic or military strength, but also on the durability and strength of its institutions. It is precisely these that the Trump administration is eroding — something even his devoted base might one day come to rue.

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