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DOLLAR DOMINANCE: PRESERVING THE U.S. DOLLAR'S STATUS AS THE GLOBAL RESERVE CURRENCY

HEARING

BEFORE THE

SUBCOMMITTEE ON NATIONAL SECURITY, ILLICIT FINANCE, AND INTERNATIONAL FINANCIAL INSTITUTIONS

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DOLLAR DOMINANCE: PRESERVING THE U.S. DOLLAR'S STATUS AS THE GLOBAL RESERVE CURRENCY

Wednesday, June 7, 2023

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON NATIONAL SECURITY,
ILLICIT FINANCE, AND
INTERNATIONAL FINANCIAL INSTITUTIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:01 a.m., in room 2128, Rayburn House Office Building, Hon. Blaine Luetkemeyer [chairman of the subcommittee] presiding.

Members present: Representatives Luetkemeyer, Barr, Williams of Texas, Loudermillk, Meuser, Kim, Nunn, De La Cruz, Ogles; Beatty, Gonzalez, Nickel, Pettersen, Foster, and Vargas.

Also present: Representative Green.

Chairman LUETKEMEYER. The Subcommittee on National Security, Illicit Finance, and International Financial Institutions will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency."

I now recognize myself for 5 minutes to give an opening statement.

First, we would like to thank our very impressive set of witnesses for being here today. You possess tremendous expertise on the U.S. dollar and global economics, and we look forward to your insights.

The U.S. dollar has been the preferred global currency since the end of World War II, providing our nation with inherent economic advantages as well as responsibilities. Today, an estimated 88 percent of all currency transactions by value are conducted in U.S. dollars. Among other things, this limits the risk of a balance-of-payments crisis, which inherently lowers our exchange rate risk. The dollar's position also allows the United States and Americans to borrow at rates such as 50 to 60 basis points lower.

Our currency strength not only benefits the U.S. Government, but it also helps American consumers by lowering the price of imported goods, resulting in an estimated $25 billion to $45 billion a year in savings.

Further, the dominant dollar offers investors dependability and a save haven in times of economic uncertainty, as seen during the

2008–2009 financial crisis, and more recently in the economic shock caused by the coronavirus pandemic.

Finally, possibly the most important advantage of having the global reserve currency within our country is embedded in the title of our subcommittee: "National Security." The dollar's status allows us to apply powerful economic sanctions, which when used properly as a targeted tool, can alter our adversaries' actions in a way that advances U.S. and global security.

Today, the biggest threat to American and global security is the Chinese Communist Party (CCP). Next week, Treasury Secretary Yellen will appear before our committee, and one thing I hope to find out is, does this Administration have a plan for when China inevitably attacks Taiwan? I asked the same question of Under Secretary Nelson in April and was not impressed by his answer. And I asked that same question of Fed Chairman Powell and was not impressed with his answer. We have concerns about that.

Committee Republicans have seen the writing on the wall and have acted by putting forward meaningful legislation. I only hope that the Administration also has some foresight.

Sanctions are a powerful tool, and their use should not be considered lightly. As such, diverse opinions exist on the effectiveness of the U.S. approach to sanctions. Some believe that carrying out sanctions too broadly rather than in a targeted manner can have a negative effect and ultimately undermine dollar dominance. And some believe we should use every tool in our kit to maximum effect.

Because of the formidable impact that U.S. unilateral sanctions can have, adversaries and even some friends have sought alternative payment methods and systems. It is anticipated that when the BRICS—which stands for Brazil, Russia, India, China, and South Africa—have their annual summit this summer, they will discuss the feasibility of a common currency mechanism for trade among their countries as an alternative to the dollar. Other countries, including Saudi Arabia, Iran, Argentina, the UAE, Algeria, Egypt, Bahrain, and Indonesia have also expressed interest in such a mechanism. While I don't think this idea is practical in the moment, something like it could materialize in the not-so-distant future.

China is also engaged in creating an alternative in the form of a central bank digital currency (CBDC), which the Chinese communist security agencies intend to use to surveil the financial activity of any user. Because this eCNY presents an assault on financial privacy and has a risk to our national security, I introduced H.R. 804, the Chinese CBDC Prohibition Act of 2023. This bill prohibits U.S. money services businesses from engaging in transactions involving a central bank digital currency issued by China.

Eventually, the United States will need to make a decision. Do we open the door to the expansion of CCP's digital dollar, or do we slam it shut? My bill slams the door and locks it.

Finally, our own domestic actions should make dollar-based assets less attractive, particularly, the unsustainable Federal spending trajectory and resulting inflation that has spread around the world. We must take this risk seriously. It is all too clear that inflation is undermining U.S. national security.

The good news is that despite attempts by the Chinese government and other bad actors, the dollar seems secure for now, as there is no clear or immediate alternative to serve as a global reserve currency. But to ensure that remains the case, we must keep our eye on the ball and preserve and protect this key national asset.

With that, the Chair now recognizes the ranking member of the subcommittee, the gentlewoman from Ohio, Mrs. Beatty, for 4 minutes for an opening statement.

Mrs. BEATTY. Good morning. Thank you, Mr. Chairman, for holding this hearing. And thank you to our witnesses for appearing here today to discuss the preservation of the U.S. dollar as the global reserve currency, a topic which we all agree is of the utmost importance.

The U.S. dollar is considered the global reserve currency because roughly 60 percent of central bank reserves around the world are held in U.S. dollars. The dollar is the preferred currency for international trade, oil is priced and settled in U.S. dollars, and nearly 90 percent of transactions in foreign exchange markets involve, yes, the dollar.

The market for U.S. Treasuries is also the deepest and most-liquid market in the world, and the reliability and stability of U.S. capital markets makes the dollar the preferred currency for investors.

The dominance and supremacy of our currency affords the United States numerous benefits, from reduced borrowing costs, to increased financial stability, to influence over global financial markets. It also allows us to leverage economic measures against those that seek to threaten our national security and foreign policy.

Given the undeniable value of the U.S. dollar's dominance, it is critical that we address the currency and the present threats to it. As we speak, foreign adversaries like Russia and China are actively working to undermine the U.S. dollar and cripple our global power and influence. We see this in Russia's rapid accumulation of gold reserves over the last decade, as well as China's development of non-SWIFT (Society for Worldwide Interbank Financial Telecommunications) systems to settle and clear transactions involving the renminbi (RMB).

Furthermore, several other countries are pushing efforts to bypass the use of the U.S. dollar in the U.S.-led financial system. That is why I agree that the subject of this hearing unquestionably deserves our time and attention in Congress and in this subcommittee. Thank you, Mr. Chairman.

However, I can't help but note the irony of my colleagues holding this hearing after months of threatening a default on our debt that would undermine the strength of the U.S. dollar. While we are discussing the threats of the dollar's dominance, let us not forget that the biggest threat to the dollar is political brinkmanship and hostage-taking, a tactic that we witnessed by the other side of the aisle, and that is conspicuously employed only when a Democrat is in charge. It is paramount that we preserve the trust and confidence that the world has in the ability of the United States to pay its debt.

Just yesterday, our Financial Institutions Subcommittee held a hearing on the debt ceiling and Treasury Department calculations, and our witnesses unanimously agreed that defaulting on the debt would greatly damage the U.S. dollar's status as the global reserve currency and hand-deliver a victory to foreign adversaries that seek to replace us on the global stage.

After once again coming within hours of defaulting on our debt and collapsing our economy, perhaps it is time to consider measures that will prevent the weaponization of the debt ceiling debate. The U.S. economy and the U.S. dollar is not a political tool.

I look forward to continuing the efforts of my fellow Committee Democrats who have led the charge to protect and promote the United States competition and our standing on the global stage. Once again, I thank our witnesses for their presence here today, and I look forward to your testimony.

And with 1 second left, I yield back, Mr. Chairman.

Chairman LUETKEMEYER. The gentlelady yields back.

With that, we will go to our witnesses for today: Dr. Tyler Goodspeed, a Kleinheinz Fellow at Stanford University; Dr. Michael Faulkender, the Dean's Professor of Finance at the University of Maryland, and Chief Economist at the American First Policy Institute; Dr. Daniel McDowell, an Associate Professor of Political Science at the Maxwell School of Citizenship & Public Affairs at Syracuse University, and a Wilson China Fellow at the Wilson Center; Mr. Marshall Billingslea, a Senior Fellow at the Hudson Institute; and Professor Carla Norrlof, a Nonresident Senior Fellow at the Atlantic Council, and a professor at the University of Toronto.

I thank each of you for taking the time to be here today. Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Dr. Goodspeed, welcome, and you are now recognized for 5 minutes.

STATEMENT OF TYLER GOODSPEED, KLEINHEINZ FELLOW, HOOVER INSTITUTION AT STANFORD UNIVERSITY; AND CHIEF ECONOMIST, GREENMANTLE LLC

Mr. GOODSPEED. Good morning. Thank you, Chairman Luetkemeyer, Ranking Member Beatty, and members of the subcommittee. I am a Kleinheinz fellow at the Hoover Institution at Stanford University and chief economist at Greenmantle LLC, a global macroeconomic and geopolitical advisory firm.

From 2017 to 2021, I had the privilege to serve on the President's Council of Economic Advisors as Senior Economist, Chief Economist for Macroeconomic Policy, Member, and Acting Chairman.

In 2022, as the ranking member highlighted, 88 percent of all foreign exchange transactions, by value, involved the United States dollar, a figure that has been roughly constant since 1989, which is testament to the substantial past dependence in international currency usage due to large positive network externalities. As the ranking member also highlighted, 59 percent of all official foreign

exchange reserves were held in U.S. dollars, which is down from a figure of 71.5 percent in 2001.

By comparison, 31 percent of all foreign exchange transactions, by value, involve the euro, which is the second-most commonly-transacted currency, which accounted for 20 percent of official foreign exchange reserves.

The fact that 90 percent of all foreign exchange transactions continue to involve the United States dollar and that global central banks continue to hold almost 60 percent of their foreign exchange reserves in U.S. dollars confers net economic benefits on the United States economy.

First, foreign demand for reserves of U.S. dollars raises demand for dollar-denominated securities, in particular, United States Treasuries. This effectively lowers the cost of borrowing for U.S. households, U.S. companies, and Federal, State, and local governments. It also means that, on average, the United States earns more on its investments in foreign assets than we have to pay on foreign investments in the United States, which allows the United States to import more goods and services than we export.

Second, foreign demand for large reserves of U.S. dollars and dollar-denominated assets raises the value of the dollar, and a stronger dollar benefits U.S. consumers and businesses that are net importers of goods and services from abroad.

Third, large reserve holdings of U.S. currency abroad, in effect, constitutes an interest-free loan to the United States worth about $10 billion to $20 billion per year.

Fourth, the denomination of the majority of international transactions in U.S. dollars likely modestly lowers the exchange rate risks faced by U.S. companies.

Fifth, given the volume of foreign U.S. dollar holdings and dollar-denominated debt, monetary policy actions by foreign central banks generally have a smaller impact on financial conditions in the United States than actions by the United States' central bank have on financial conditions in other countries.

However, the benefits of the U.S. dollar's global reserve status are not without costs. The lower interest rates in the United States benefit U.S. borrowers, especially the Federal Government. They also lower returns to U.S. savers.

In addition, although a stronger dollar benefits U.S. consumers and businesses that net import goods and services from abroad, it does also disadvantage U.S. firms that export goods and services abroad as well as firms that compete against imported goods and services.

Furthermore, the perception of the U.S. dollar as a safe-haven asset means that demand for the dollar tends to increase in response to adverse macroeconomic events that are global in nature. As a result, the competitiveness of U.S. exporters and U.S. firms that compete against imported goods and services are likely to face an increased competitive disadvantage at times of elevated global macroeconomic stress.

However, despite these costs, studies generally find that the economic benefits of the dollar's prominent global status outweigh the costs, providing a modest net benefit to the United States economy. This does not include the substantial benefit to which the chairman

referred of the United States dollar's centrality in global transactions, allowing the United States to utilize financial sanction tools when appropriate in support of national security objectives.

There are economic policies that would help to preserve this net economic benefit. Prudent fiscal policy, avoiding excessive levels of regulation that would allow for continued financial innovation to occur within the United States rather than without, restoring low and stable inflation.

I look forward to your questions and participating in this important economic discussion.

[The prepared statement of Dr. Goodspeed can be found on page 49 of the appendix.]

Chairman LUETKEMEYER. Thank you, Dr. Goodspeed.

Dr. Faulkender, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE MICHAEL FAULKENDER, DEAN'S PROFESSOR OF FINANCE, ROBERT H. SMITH SCHOOL OF BUSINESS, UNIVERSITY OF MARYLAND; AND FORMER ASSISTANT SECRETARY, ECONOMIC POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. FAULKENDER. Thank you, Mr. Chairman, Ranking Member Beatty, and members of the subcommittee. Thank you for the opportunity to speak with you today on dollar dominance, Federal fiscal mismanagement, and the implications for our nation's economy.

I had the honor of serving as Assistant Secretary for Economic Policy at the Department of the Treasury during the previous Administration. In that role, I worked with Members on both sides of the political aisle and with the Small Business Administration to quickly implement the Paycheck Protection Program (PPP) to ensure that the economic devastation that might have resulted from the pandemic was not realized.

As Assistant Secretary, I told my team that the Treasury Secretary proudly states that the dollar will never not be the world's reserve currency, and our job is to make sure that is true. Maintaining that role means engaging in prudent economic stewardship, continuously upgrading the technology supporting the nation's payment system, and showing restraint in our deployment of unilateral sanctions. Most importantly, we must demonstrate to the rest of the world that we are financially responsible by addressing our unsustainable fiscal path.

To understand why this is the case, we must start with the role of money. Academic literature has identified three purposes of money: one, to facilitate the exchange of goods and services; two, to serve as a store of value from when the money is received until it is used; and three, to act as a unit of measurement.

One reason the dollar is the world's reserve currency is because approximately half of global trade is invoiced in U.S. dollars, even though U.S. trade only accounts for approximately 10 percent of global trade.

Some countries peg their currency to the dollar, bringing greater stability to their trade with the United States by removing currency risk. However, to keep the peg in place, those countries must also adopt the interest rates of the U.S. Federal Reserve, causing interest rate effects here to be exported abroad.

Foreign companies operating in non-dollar-pegged currencies may still invoice in dollars because they want a currency easily converted and that stores value in the interim. As has been recognized by both the chairman and the ranking member, a significant portion of trading in spot, forward, and swap markets features the U.S. dollar in one leg of the transaction.

Our financial markets are the most-liquid in the world. Transactions are implemented at low cost with fast execution and minimal price impact. Thus, part of maintaining our role as the world's most-transacted currency means keeping our markets open with ongoing improvements in technology that speeds order implementation while safeguarding against illicit transactions and cybersecurity threats.

Most importantly, dollar dominance is aided by policies that reinforce the dollar's historical strength and stability. When fiscal and monetary policy generate robust economic growth with low inflation, the U.S. dollar is stronger and less-volatile, thus serving the important second role of money as a store of value. In contrast, stagnant growth and high inflation do not serve foreign transactors looking to mitigate currency risk.

During COVID-19, aggressive fiscal policy was essential to ensure that our nation's families and small businesses survived its devastation. By January 2021, the economy had nearly fully recovered from the pandemic. Nevertheless, Congress and the Administration enacted an additional $1.9 trillion in Federal spending, resulting in the highest inflation our nation has endured in 40 years.

Even last year, well after the pandemic had ended, Federal spending was still 24 percent of national output, significantly above its 20-person average that existed between 1980 and the onset of the pandemic.

Under current projections, our debt is anticipated to reach 566 percent of national output by the end of the 75-year forecast period in the financial report of the U.S. Government. Our growing debt erodes confidence around the world that the U.S. will continue being a responsible economic steward worthy of its status as the world's reserve currency.

Given the outsized role of the Federal Government in our economy, recent growth has been anemic. Inflation is still well above the Federal Reserve's 2-percent target. Inflation-induced interest rate hikes have resulted in three of the four largest bank failures in U.S. history.

Yet, there seems to be an insistence on throwing more gasoline on the stagflation fire. Washington directed spending that replaces low-cost, reliable sources of energy with high-cost, unreliable sources of energy. It creates both inflation and contraction.

The Federal Reserve alone cannot mitigate the inflationary impacts of fiscal and regulatory policy. Higher interest rates further undermine the banking system and erode the value of the dollar. Instead, the Federal Reserve needs help from Congress and the Administration. They should reduce Federal spending, and rescind regulations that are curtailing economic growth and devaluing the dollar.

Policymakers must return to the responsible fiscal stewardship that made the U.S. the premier economic and financial nation in

the world. Reduced government spending facilitates greater private sector ingenuity and dynamism, thereby improving living standards for the American people.

I look forward to participating in this important conversation. Thank you.

[The prepared statement of Dr. Faulkender can be found on page 46 of the appendix.]

Chairman LUETKEMEYER. Thank you, Dr. Faulkender.

Dr. McDowell, you are recognized for 5 minutes.

STATEMENT OF DANIEL MCDOWELL, ASSOCIATE PROFESSOR, MAXWELL SCHOOL OF CITIZENSHIP & PUBLIC AFFAIRS, SYRACUSE UNIVERSITY

Mr. MCDOWELL. Thank you. Chairman Luetkemeyer, Ranking Member Beatty, and distinguished members of the subcommittee, it is my honor to be speaking with you today about preserving the U.S. dollar's status as the world's preeminent international currency.

I would like to open with my bottom line up-front. As the United States has increased its reliance on financial sanctions as a tool of foreign policy, it has provoked anti-dollar policy responses from our adversaries. While such steps are unlikely to upend the dollar's position as top international currency, including the reserve currency role, over time, such policies could diminish the coercive capabilities that the United States derives from dollar centrality.

Although our republic has never been ruled by a monarch, the U.S. dollar has become a powerful symbol of American financial royalty. Indeed, the dollar is often described as the king of all currencies and rightly so. Across the full spectrum of international roles that a national currency can play—the reserve currency role, cross-border payments and trade settlement, turnover in foreign exchange markets, and so on—America's currency outcompetes all comers and presently lacks a true rival in this space.

Dollar preeminence and U.S. financial centrality are not without consequence for American coercive power, as you all know. With little more than the stroke of the President's pen or through an Act of Congress, the U.S. Government can use financial sanctions to impose enormous economic costs on targeted foreign actors, be they individuals, firms, or State institutions, by freezing their dollar assets or cutting them off from access to the banks through which those dollars flow.

The consequences for individual targets known as Specially Designated Nationals (SDNs) are severe, significantly impairing the target's capacity to participate in international trade, investment, and debt repayment, and depriving them of access to their wealth.

Over the last 2 decades, the United States has used the tool of financial sanctions with increasing frequency. For example, in the year 2000, just 4 foreign governments were directly targeted under a U.S. Treasury country program overseeing the Office of Foreign Assets Control (OFAC). Today, that number is greater than 20, and if we include penalties from secondary sanctions, the list gets even longer.

The more that the United States has reached for financial sanctions, the more it has made adversaries and foreign capitals aware

of the strategic vulnerability that stems from dependence on the dollar. Some governments have responded by implementing anti-dollar policies, measures that are designed to reduce an economy's reliance on the U.S. currency for investment in cross-border transactions. Although these measures sometimes fail to achieve their goals, others have produced modest levels of de-dollarization.

Notable examples here include Russian steps to cut its dollar reserves and reduce the use of the dollar in trade settlement in the years leading up to its full-scale invasion of Ukraine, or China's ongoing efforts to build its own international payments network based on the yuan, efforts that have taken on a new sense of urgency as Beijing has become more aware of its own strategic vulnerabilities from dollar dependence.

To be clear, I do not believe that geopolitically-motivated moves by Russia, China, or any other country gravely threaten the dollar's supremacy in the near or immediate term. The dollar remains the world economy's indispensable currency and maintains economic and political advantages over all alternatives. However, the growing number of states espousing anti-dollar viewpoints and adopting anti-dollar policies does threaten to weaken the future potency of U.S. financial sanctions.

I will conclude my remarks with three suggestions for U.S. sanctions policy moving forward, aimed at protecting the dollar's global status and preserving the tool's effectiveness for moments when U.S. interests are most gravely threatened.

First, the United States should reconsider the use of so-called symbolic financial sanctions. That is, if the main objective of a tranche of sanctions is to signal to the world or to a domestic audience that Washington disapproves of a foreign government's policy choices, other measures that can send a similar signal but do not politicize the dollar system ought to be considered first.

Second, the use of financial sanctions against issuers of potential rival currencies—in particular, China and its yuan—should face a higher bar of scrutiny. Even a small targeted-sanctions program provides information to our adversaries about their vulnerabilities and gives them time to prepare for a future event when a broad U.S. sanctions program may be called upon as part of a major security crisis when such measures will be most needed.

Finally, whenever possible, U.S. financial sanctions should be coordinated with our allies in Europe and Asia, who should feel as if they are key stakeholders in the dollar system and not vassals to it. Such coordinated efforts will prevent our friends from seeking to conduct business with U.S. adversaries outside of the dollar system and will send a message to the whole world that moving activities into secondary currencies like the euro or the yen is not a safe haven.

It is my privilege to be here with you today and speak on this critically important issue. And I am happy to answer your questions.

[The prepared statement of Dr. McDowell can be found on page 51 of the appendix.]

Chairman LUETKEMEYER. Thank you, Dr. McDowell.

Mr. Billingslea, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE MARSHALL BILLINGSLEA, SENIOR FELLOW, HUDSON INSTITUTE; AND FORMER ASSISTANT SECRETARY FOR TERRORIST FINANCING AND FINANCIAL CRIMES, U.S. DEPARTMENT OF THE TREASURY

Mr. BILLINGSLEA. Thank you, Mr. Chairman. It is great to be back with this committee, this time in a personal capacity. The last time I was here was as Assistant Secretary of the Treasury for Terrorist Financing and Financial Crimes during the Trump Administration, where we talked about a wide range of sanctions programs that we were imposing.

I will say at the outset that I agree with you and others that, to paraphrase Mark Twain, reports of the dollar's demise have been greatly exaggerated. That being said, we need to remind ourselves that in the 16th Century, the Spanish silver dollar was the dominant currency. In the 17th Century, it was Dutch florins. In the 18th Century, it was the pound sterling.

The link between a nation's currency and its role as the relatively-dominant political actor on the world stage is pretty clear. And that is why people like Lula de Silva from Brazil, Vladimir Putin, and Xi Jinping all aspire to undercut the role of the dollar as the global reserve currency.

In my view, Chairman Xi poses the most serious threat to this effort. He has dictatorial control of Communist China. He has purged all of his main rivals. He has a vision of China as the Middle Kingdom to which all of the nations on the periphery ultimately will pay tribute. And some cultures, like the Uyghurs, will be enslaved and eradicated.

And to that end, he has overseen a massive expansion in Chinese conventional military capability, an unprecedented nuclear weapons buildup, and he is now ominously threatening invasion of Taiwan. It should therefore come as no surprise that he, via the People's Bank of China, would like to both undercut the dollar and sanctions-proof the Chinese economy as they plan for that invasion of Taiwan.

If we look at what Russia did in the run-up to its further invasion of Ukraine, they began dumping ownership of Treasury bonds in 2018. In that year, they plummeted from $96 billion in holdings down to $15 billion, and they also started buying large amounts of gold.

China is now, as the ranking member has observed, embarking on its own gold-buying spree. I haven't seen the data from May, but April marked the sixth straight month of Chinese expansion in its gold holdings. And I am not sure I believe the official figures. We have to recall that China is the dominant gold-mining player around the world, and half of those gold-mining companies are state-owned, so the actual size of China's war chest when it comes to gold reserves may be far higher. In fact, I suspect it is inevitably far higher than official numbers suggest.

Last year, China also started dumping its Treasuries—2022 marked the second-largest decrease on record, with a drop of about $174 billion, and China stood at the lowest levels since 2010 in terms of its holdings, although this past March, they did reverse course. This bears close watching because a sell-off may be a strong indicator of planned aggression.

But I think the area where we really need to focus, and where I would agree with you, Mr. Chairman, is that I am not sure the Treasury has a plan. How do we deal with the fact that the sheer size of the Chinese economy dwarfs what we have been contending with in the form of Iran, Russia, and so on?

One of the first things the Biden Administration did in the wake of Russia's attack was start sanctioning Russian banks and de-SWIFTing them. And that is one thing when you are going after an economy smaller than the size of Texas. It is quite another when you consider that, out of the 100 largest banks in the world, China has 20, and all 4 of the top 4 are Chinese banks. And that is why many within the Treasury contended when I was there, and they still contend to this day, that these Chinese banks are simply too big to sanction.

I don't agree that we can allow that to stand, but I do believe we have to start taking very swift action to put us in a situation where we could take punitive measures on these banks if necessary.

And to that end, it is good that the market is beginning to respond to Chinese bellicose rhetoric. We have seen the Chinese stock market and the capitalization of Chinese companies come way down. We have also seen a drop in most of the major indexes. We have also seen the three biggest banks in the United States start to trim their exposure. But I believe we need to encourage further reduction.

And to that end, one of the things we should do is increase the capital requirements on banks that have substantial exposure. We need to ensure that our largest banks can withstand the systemic shocks that would arise from a tit-for-tat with China.

We also need to recognize, as the Atlantic Council has pointed out, that China holds over $5 billion in various liabilities to western investors that they could hold hostage in the event of a sanctions war. And we need to begin educating our pension funds and our investment funds on the substantial risk that they run by leaving those assets in China.

Again, I appreciate the chance to testify before this committee, and I look forward to your questions.

[The prepared statement of Mr. Billingslea can be found on page 40 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Billingslea.

And Professor Norrlof, you are recognized for 5 minutes.

STATEMENT OF CARLA NORRLOF, NONRESIDENT SENIOR FELLOW, GEOECONOMICS CENTER, ATLANTIC COUNCIL; AND PROFESSOR OF POLITICAL SCIENCE, UNIVERSITY OF TORONTO

Ms. NORRLOF. Thank you, Chairman Luetkemeyer and Ranking Member Beatty, for inviting me to testify on this important topic. I am honored.

I will speak to three themes: the dollar's dominance; threats to dollar dominance; and what the U.S. should do to maintain dominance. And my written statement provides further explanation and context.

The dollar is the most-important currency in the world for both official and private actors, although its dominance has been declining since the 1970s, and there has been a recent downward cycle since 2016. Now, dominance can simply mean relatively stronger than anyone else, but here I take dominance to mean a currency that other currency majors are unable to balance, effectively, a unipolar currency order.

I will note that the dollar's dominance is not quite as strong amongst private actors and private markets as it is with governments. In private transactions, it averages about 45 percent of the world's total. That includes ethics transactions, but also things like issuance of international debt securities and cross-border banking.

On threats to dollar dominance, the Russia sanctions have had little impact to no impact, actually, on dollar dominance. In fact, given the recent uptick in the dollar's reserve currency status, sanctions may be reinforcing dollar dominance.

The Chinese yuan poses no immediate threat to dollar dominance. It accounts for roughly 3 percent of overall reserves. And so far, China has been successful in promoting the yuan with its trade partners, but the yuan is scarcely used by countries outside trade with China.

China is a potential long-term challenger due to its active pursuit of trade and investment relationships. If the yuan is increasingly used by third countries, it will pose a greater threat to the dollar. And in addition to these external threats, there is also a domestic threat. Flirting with the possibility of a voluntary default puts dollar dominance at risk.

What should the U.S. do to maintain dominance? To curb the domestic threat, Congress should consider creating an alternative mechanism for resolving political differences on government spending and its consequences. To rein in external threats, the United States should, whenever possible, implement multilateral sanctions in support of broadly-endorsed goals to shore up the liberal international order. This is likely to limit dollar backlash. To counter China's advances, the U.S. should consider economic inducements, in addition to its use of sanctions, as a tool of economic statecraft.

The United States cannot afford to alienate security allies in this geopolitical environment. Security relationships are increasingly informing economic relationships. Just as countries are starting to source goods from friendly nations, they may adopt friendly-nation currencies as they did during the Cold War.

Thank you.

[The prepared statement of Dr. Norrlof can be found on page 53 of the appendix.]

Chairman LUETKEMEYER. Thank you for your testimony.

And I thank each of you for your testimony this morning. It was very impressive.

And with that, I will now recognize myself for 5 minutes as we begin the questioning portion of our hearing.

The conversation around the dollar being the reserve currency is becoming louder and louder as we have more and more, I think, threats to it. I think I agree with all of you that there is not an immediate threat within the next few years. But as a businessman, I usually look at not only short-term problems, but I look at long-

term problems. And I look from 30,000 feet. And from 30,000 feet, and from a long-term perspective, I see the threat that each of you have discussed this morning with regards to China. They are trading now in their own currency with their friends and allies. As that sphere of influence gets bigger, it chips away at our reserve currency. I think one of you gave some statistics on it.

So, I would like to talk a little bit about how we are forcing them into this position from the standpoint that—I think each of you made the comment—Dr. McDowell made a comment with regards to the history of the currency.

We are looking at a currency that is being challenged now because we are putting sanctions on China, and they are looking at other ways to get around it. As long as our friends are our friends, they are okay with our dollar. When the enemies are getting pushed into a corner, they look for ways to get out of it, and our dollar is a way to control people, and they don't want to be under our control. Therefore, they are looking at ways to get around it.

Mr. Billingslea, would you comment on that? They seem to be decoupling themselves from our own—trying to establish their own currency. Where do you see this going in the next, say, 20 years?

Mr. BILLINGSLEA. Thank you, Mr. Chairman. I think that their desire to establish their national currency as a true international currency fits hand-in-glove with their vision of themselves as the dominant player on the world stage, or at least that is what they would like to become.

I agree with you that for the time being, I don't see that they are going to have all that much success in establishing yuan as a hard currency globally for basically two reasons. One, China is a currency manipulator, so people who hold the yuan are also holding a lot of risk that it may not have the same value tomorrow that it has today. And two, they have a very restrictive capital outflow regime that basically prevents you from moving currencies out of the country. They are very closed in that respect. And those are going to be their two main impediments.

The thing I do worry about—and I come back to the fact that they have been buying a lot of gold, which would be very concerning if they wind up having larger reserves of gold than we believe—is that they could start issuing gold-denominated, gold-backed yuan contracts. And that would further their ambition for introducing the yuan onto the world stage.

But at the moment, the yuan is not a widely-held reserve currency. In fact, a third of all yuan reserves are sitting in Russia today. Thank you, Mr. Chairman.

Chairman LUETKEMEYER. Believing or suggesting, perhaps, that they go into Taiwan, how would this affect our reserve currency status with them—basically, the world would be in a lock-down position for a period of time until that situation is resolved because they will invade, we will sanction, and off we go.

I think a couple of you talked about the sanctions being something we have to be very careful about how we manipulate. It can be counterproductive. Would somebody like to comment on that?

Mr. MCDOWELL. Yes. Chairman Luetkemeyer, thank you for a great question.

My own view on China here is that their short-term efforts are focused primarily on increasing their resilience and autonomy in the event of a future sanctionings package from the United States, perhaps as a result of a conflict with Taiwan.

Their focus, I think, is on trade settlement and cross-border payments. That is where I think we are seeing most of the developments. Right now, around 20 percent of China's cross-border trade is settled in its own currency. That is up over the last few years after reaching 30 percent prior to 2015.

The reason they are focused on that is I think the strength of our sanctions are actually more on stopping firms, individuals, and government institutions from participating in cross-border trade and payments, more so than even freezing assets, which is sort of a one-time, one-off sanction. Whereas, cutting actors off from banks means your ability to participate in cross-border trade, debt payment, et cetera, is constrained for as long as those sanctions are in place.

And the Chinese have been interested, I think, in improving the use of the yuan through networks like the Cross-Border Interbank Payment System (CIPS)—piloting eCNY and other things like that—which will eliminate their 100-percent reliance on using the dollar and the dollar system.

Chairman LUETKEMEYER. As the last thing, I would like to really follow up with regards to your gold comment, Mr. Billingslea, because it looks to me like, at some point, there may be a shift to the gold standard again. And if that is happening, if they are going to push us in that direction, it would be interesting to at least play a, "what-if," game of what could happen there.

My time is up. With that, I will recognize the ranking member of the subcommittee, the gentlelady from Ohio, Mrs. Beatty, for 5 minutes.

Mrs. BEATTY. Thank you, Mr. Chairman.

And, again, thank you to the witnesses.

Let me echo what the chairman and I were talking about. Certainly, your presentations—all of you were not only quite impressive and scholarly, but this is probably one of the best panels that I have witnessed on this topic. So, again, thank you for that.

Not to mention, Mr. Chairman, let the record show that they did quote me several times.

With that, let me move to the first question to Dr. Norrlof. I would like to start with other countries' efforts to replace or bypass the U.S. dollar. We have heard from all of you a lot about China and Russia increasing their gold reserves, the use of alternative payment systems, and certain African nations also partnering up to develop a multilateral system that evades the dollar.

Can you tell me if there is any one thing that stands out to you, that you can share with us about efforts led by China and Russia and other nations to circumvent the U.S. dollar and the U.S.-led financial system?

And then, Mr. Billingslea, I am going to ask you the same question.

Ms. NORRLOF. Yes. I think that those efforts are a new development, but I think that they are not very consequential because they build on the idea that local currencies will be used, the bilat-

eral currencies, and these relationships will be used. And in order to internationalize the currency, you really need to use a third-party currency, so, outside that relationship. And that is not happening on any scale that is significant whatsoever. Therefore, I see those efforts as very limited.

Now, as has been pointed out by the entire panel here, I think that there is something to still track in that these alternative payment systems allow for a relative insulation of the dollar system. And as we move forward, it is important to look at where those investment and trade relationships are going.

Mrs. BEATTY. Thank you.

Mr. Billingslea?

Mr. BILLINGSLEA. Thank you, Congresswoman. I would offer two thoughts in this respect.

The first is that China considers the actual composition of its foreign exchange reserves to be a state secret. So they don't publish, and they view it as a criminal offense to try to obtain that information in terms of the balance of how much is gold, and how much is dollar- and euro-denominated. But the numbers I have seen suggest that still, at this moment, about 50 to 60 percent of their forex reserves are still in dollars or euros, which means that they are at high risk of sanctions. We can affect them.

The problem is that the war chest that they built up is enormous. It is more than $3 trillion that they have in forex reserves. Compare that with what Russia had at the onset of its assault, which was around $680 billion, of which we managed to freeze overseas half of it. But Russia is still keeping its economy going, despite the Biden Administration's sanctions. So imagine how they are going to be able to continue with that sizable war kitty in Beijing if they do decide to go off after the Taiwanese.

The final point on gold, the reason why regimes that come under sanctions like gold is because it is hard to trace. It is fairly anonymous. The only problem with it is that it is really, really heavy.

Mrs. BEATTY. Thank you very much.

Let me just skip to another question. And I am really asking you this because I want it to be on the record. We spent a lot of time after our debt ceiling vote on getting educated. We know we will revisit this in 2 years, in January 2025.

So let me ask all of you, and this is a yes-or-no question; I will go down the line and ask you to comment yes or no on the effect of the debt default on the strength of the U.S. dollar. Is it yes or no for you that the dollar's position as the world's reserve currency would be harmed by a default on Americas' debt? And we will start at this end.

Mr. Goodspeed, yes or no?

Mr. GOODSPEED. If the U.S. defaulted on its debt, it would harm the U.S. dollar status.

Mrs. BEATTY. Okay.

Mr. Faulkender?

Mr. FAULKENDER. I agree, yes.

Mrs. BEATTY. Okay.

Mr. McDowell?

Mr. MCDOWELL. I agree.

Mrs. BEATTY. Mr. Billingslea?

Mr. BILLINGSLEA. Absolutely.

Mrs. BEATTY. Ms. Norrlof?

Mr. NORRLOF. Yes.

Mrs. BEATTY. Thank you so much for that.

I don't know if I have time for the next question, so I will read it, and you can all respond in writing.

We know that non-U.S. mobile payment applications reportedly have reached more than 1 billion consumers and processed more than $6 million worth of transactions. So, I believe the continued advancement of these products into foreign markets can diminish U.S. competitiveness and yield opportunities for foreign governments to influence international payment.

The question to all of you will be, what do you think about that? And we will take those responses in writing.

My time is up.

Chairman LUETKEMEYER. The gentlelady yields back.

The gentleman from Kentucky, Mr. Barr, who is also the Chair of our Subcommittee on Financial Institutions, is recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman, and thank you for holding this hearing and for the witnesses' impressive testimony. This is probably the most important hearing we have held this entire Congress, and the testimony is excellent.

Let me ask Dr. Goodspeed and Dr. Faulkender about the relative risks to the dollar's dominance. We have these internal risks, regulatory failure, that diminish the dynamism of the U.S. free enterprise system. We may have bad tax policy. We have an unsustainable debt trajectory. Those are internal threats.

Then, we have these exogenous external threats: BRICS; a Saudi oil deal with China denominated into yuan; the CIPS system, which is an alternative to SWIFT; the advent of crypto; and the adoption of a Chinese CBDC. Compare the risks, and which is the more significant risk, in your mind?

Mr. GOODSPEED. Economists like to talk about the short term versus the long run, and I think that is applicable here.

Short term, I think the risk is that we continue to see diversification away from the dollar, PRC continuing to push other countries to use trade invoicing and renminbi, that they continue to promote the offshore renminbi market, that they continue to promote or force bilateral clearing.

Longer term, I think the bigger risk is that foreign investors no longer perceive the United States Federal Government debt to be as safe and risk-free as it is perceived today.

Mr. FAULKENDER. I tend to agree.

I would say that in the short run, as you see more trading take place in other currencies, just for facilitating transactions, you'll see reserve banks around the world increasing their holdings of other assets denominated in things other than dollars.

But for purposes of holding long-term reserves, ultimately, it is a claim on the underlying country. And for reasons that have been spoken to, I don't trust claims against the Chinese economy when it comes to commodity-backed currencies. One is always concerned about whether they would suspend convertibility in times of crisis,

and whether those asset-backed currencies actually will be backed by those assets when the time comes.

And instead, you are still going to be a claim against the underlying economy, which is why growth, along with fiscal stewardship, is essential to maintaining our status as what you would hold for long-term reserve assets.

Mr. BARR. It sounds like preserving the dollar's dominance, maintaining that, is both offensive and defensive. We need to be defensive when it comes to keeping our house in order, getting our house in order here at home, but also recognizing some offensive threats outside of the United States.

Mr. Billingslea, and also Dr. McDowell, I wanted to ask you about this idea of sanctions. Mr. Billingslea is advocating for a legislative proposal that would implement some investment screening, Western investment screening. It would use the architecture of OFAC to sanction Chinese entities that threaten our national security, to give a clear red light to Western investors to not invest in Chinese technology, defense, military, and surveillance companies that threaten our national security on exchanges, A-shares, outside of the United States as well.

But I wanted Dr. McDowell to speak about this idea of symbolic sanctions and politicizing the dollar. Is there a risk with that kind of approach that we would be doing what you advise against?

Mr. MCDOWELL. It sounds like what you are describing is more of an investment restriction, using sort of access to information through OFAC to prohibit or advise against investment. That is different, I think, from cutting off the firms from using dollar payments, so I think the risk is lower based on what you have just described.

Mr. BARR. Right.

And, Mr. Billingslea, are there alternatives to a central bank digital currency (CBDC) that would help maintain the dollar's dominance as China pursues a CBDC? In other words, would a stablecoin regulatory framework that would encourage stablecoins denominated in the dollar be a better alternative than the United States adopting our own CBDC? What I always say is we shouldn't counter China by becoming more like China.

Mr. BILLINGSLEA. The Chinese CBDC is a surveillance tool. And I think we all need to just understand that they are kind of very open about the fact that they intend to track holdings of this.

I also have some doubts that—if we can't even get a website for healthcare functioning, I am not exactly sure that we can build a digital dollar in any meaningful timeframe under the Federal Reserve.

There is a stablecoin already out there that is denominated in dollars, and for every dollar they issue, they do hold in reserve.

Mr. BARR. I yield back. Thank you.

Chairman LUETKEMEYER. The gentleman's time is up.

The gentleman from North Carolina, Mr. Nickel, is recognized for 5 minutes.

Mr. NICKEL. Thank you, Chairman Luetkemeyer, and Ranking Member Beatty.

And thank you to your witnesses for joining us today.

One potential threat to the U.S. dollar as the global reserve currency is the growth and expansion of alternative cross-border payment systems, such as those developed by Russia and China. Increased use of these systems could lead to a world less dependent on U.S. dollars, which would likely limit our traditional methods of economic sanctions.

Dr. Norrlof, how should U.S. national security experts be preparing to respond to this scenario?

Ms. NORRLOF. Thank you. I think that this is a long-term threat. And it really requires the countries that are pushing alternative payment systems to build economic relationships, to build commercial relationships, and to start trading in the yuan outside of established bilateral relationships.

So, I think that the best way that the United States can counter this is to start reinforcing its economic relationships by expanding trade, expanding investment.

Mr. NICKEL. Thank you.

Sanctions that are made possible by the strength of the U.S. dollar could push countries to reduce their use of U.S. dollars and minimize the global economic power of the United States. Governments could experiment with other national currencies to proactively shield their economies from the United States.

Dr. Norrlof, again to you, what inflection points would signal that major economies are making serious attempts to de-dollarize?

Ms. NORRLOF. I think that we are nowhere close to an inflection point in the reserve currency function. There is actually more movement on the private dimension.

And there were some numbers quoted here before—I think that in ethics transactions, for instance, the dollar is not as dominant as it has been made out to be; it accounts for about 45 percent of ethics transactions, because the 90-percent figure is out of 200 percent. Because currencies exist on both sides of an exchange. And we see across-the-board in the financial markets that the U.S. dollar is in fact less-dominant than it is with official holders.

Mr. NICKEL. Just to sum up here, how should policymakers like us be responding to the scenario I laid out?

Ms. NORRLOF. I think, again, the key here really is to reinforce existing relationships, economic relationships that the United States has and expand them where they do not exist. This is the best way for the United States to undercut the developments that are now underway.

Mr. NICKEL. Thank you.

And, Mr. Chairman, I yield back.

Chairman LUETKEMEYER. The gentleman yields back.

I now recognize the gentleman from Texas, Mr. Williams, who is also the Chair of the House Small Business Committee, for 5 minutes.

Mr. WILLIAMS OF TEXAS. Thank you, Mr. Chairman.

And I thank all of you for being here today.

The U.S. dollar has held a leading position in the global economy as a primary reserve currency since World War II. We talked about that. And this status has given the United States economic and political advantages to strengthen market security and boost our monetary independence.

Now, there are concerns that the rise of China's yuan and the euro and other currencies are threatening to replace the U.S. dollar as the world's reserve currency. This decision would have, as we all know, severe economic consequences. We talked about that.

However, despite challenges to the role of the U.S. dollar, other countries' currencies lack the scale and ability to serve as the workable alternative. So even still, we must continue to examine risks that threaten the dollar's global role as the reserve currency.

Dr. Goodspeed, could you elaborate some more on the dangers of replacing the dollar as the global reserve currency, and what makes the dollar the safest compared to the alternatives, and how we can better promote the retail about the global confidence in the dollar?

Mr. GOODSPEED. Sure. I have heard it said by the President, "Don't compare me to the Almighty, but compare me to the alternative." And I think something similar can be said of the U.S. dollar, that this is, as members of the panel have said, the deepest, most-liquid market for safe assets in the world. And if you are going to hold a currency, you want to be able to park that currency in a safe liquid asset that you can easily dispose of if you want to convert it.

And that is not the renminbi, for the reasons that have been cited, in particular, the capital controls. They are working to get around that by having offshore markets. And it is not the euro, because they lack a liquid market for a single homogenous debt. It is the U.S. dollar. And we benefit from that for the reasons I cited economically and for reasons that others members of the witness panel have cited in terms of national security.

Mr. WILLIAMS OF TEXAS. Thank you.

In recent years, China has conducted a series of strategic initiatives aimed at challenging the dominance of the U.S. dollar. One specific strategy has been currency manipulation. The Chinese have been manipulating their currency to gain unfair advantages in international trade, and Communist China is creating an unlevel playing field by imposing capital controls and limiting the currency flowing in and out of China. This negatively impacts countries with market-driven exchange rate systems by creating doubts about the convertibility of the yuan. So, we must put an end to this manipulative practice and protect U.S. interests by holding China accountable.

Mr. Billingslea, what actions are the Chinese Communist Party (CCP) taking to undermine the global role of the U.S. dollar, and how can we hold them accountable for their manipulation of currencies while maintaining our dominance?

Mr. BILLINGSLEA. I think it is important that the Treasury resume calling it what it is, which is a currency manipulator. We did that under the Trump Administration. I also would point out that we run a trade deficit with the Chinese, and what that means is they export more to us than they import from us. All of that delta between what we buy versus what they buy goes into that war chest that they are building up. That is their forex reserves.

Under the Biden Administration, the amount of that bilateral trade and the deficit has surged yet again from what it was when he took over in 2020.

So, we do need to look at how to become much more competitive and to insist on a more-equitable balance of trade.

Mr. WILLIAMS OF TEXAS. My last question, during past economic crises, like the financial crisis of 2008 and the 2020 COVID pandemic, the dollar remained strong on the world stage. However, there is a concern that the rapid rise of inflation our nation is currently facing is not only hurting us at home, but is also hurting our reputation abroad.

The Biden Administration has fueled the economic downturn our country is facing, and many Americans are struggling to keep up with increasing costs for groceries, gas, and housing. And on top of all of that, small businesses—of which I am one—are crippled behind inflation and rising interest rates.

Despite warnings, this Administration continues their reckless spending spree that has brought on the highest inflation in decades. Dr. Faulkender, quickly, can you expand on how record-high inflation is affecting the U.S. dollar globally? How can the government boost dollar assets to protect our financial markets and make us more attractive?

Mr. FAULKENDER. Absolutely. As you said, during the onset of the pandemic, it was necessary to engage in significant spending to support American households. But since then, the ongoing spending well in excess of historical levels has meant that there are way too many dollars chasing too few goods and services, and American families and small businesses have struggled the most.

The issue that we also have is that we have called upon foreign countries, largely through the budget deficits we run, to hold those dollar-denominated assets as part of their reserves. And what that does is contribute to the very trade deficit we are talking about.

So, to the extent that we wanted to not facilitate China's buildup of a war chest, running something closer to a balanced budget that does not necessitate foreign countries buying our debt would be beneficial.

Mr. WILLIAMS OF TEXAS. Thank you.

I am out of time. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

The gentlelady from Colorado, Ms. Pettersen, is recognized for 5 minutes.

Ms. PETTERSEN. Thank you all so much for being here today. This is a very important conversation, and it has been on all of our minds after going through the debt ceiling debate and what might happen if we were unable to come to an agreement. This is my first year in Congress, but I have been watching this for a long time, and the hostage-taking that unfortunately has taken place every time this comes up is deeply concerning.

And it is even more concerning to me, having gone through it now in this body. When I think about the long-term impacts, the message that this sends globally when people have to question whether or not investing in the United States is viable, and whether or not the United States of America will pay its bills, that is a huge security risk, and we made it past this time, even though I think that the tactics you used were deeply disappointing.

But I am very concerned about this in the long term. And when I think about some of my colleagues who oftentimes talk about the

threat to China, inadvertently, this is—China would want nothing more than what we have gone through and what the potential consequences are.

It would reduce the value in the dollar, the security of the United States and our reputation, and our long-term investments here in this country.

So, do you think that it is in the best interest of our national security and the strength of our dollar to address the debt ceiling and take that off the table for the United States?

Ms. NORRLOF. Was that question directed to me?

Ms. PETTERSEN. Anyone who would like to answer.

Ms. NORRLOF. I think it is very detrimental to the United States' credibility and to the dollar status in the world. I also want to underline that any default that occurs on the part of the United States is entirely voluntary. There can be no forced sovereign default in the case of the United States.

Mr. BILLINGSLEA. Congresswoman, the dilemma is that once you issue debt, you need to honor it, so defaulting on that would do grave harm. But the problem is that at a certain point, if you keep issuing debt and debt and debt and you have runaway spending, that also winds up biting you, because it begins to call into question whether or not we actually can be trusted to honor that debt.

So there is a balance here, but it is clear that the profligate spending really does have to come to an end.

Ms. PETTERSEN. Absolutely. And I think that everyone here in Congress is concerned about the debt that the United States has and has different approaches on what we need to do to deal with that. But that should be a legislative process and much more long-term planning than the hostage taking that we have seen.

Something that you brought up, Mr. McDowell, was around the symbolic financial sanctions that have been used if we don't agree with a country politically. And one that immediately comes to mind, that has impacted my community and is still on the books, is the sanctions on Canada for lumber that has increased costs for housing and actually addressing the needs there.

I don't know if you have any other examples of what that looks like, but making sure that we use these sanctions very strategically, and that we should consider other measures to send signals to countries so it is not compromising our dollar.

Can you give examples of what those measures look like, recognizing, of course, that utilizing these economic tools is important for ensuring peace, but making sure that they are very limited?

Mr. MCDOWELL. Yes, thank you for that question, Congresswoman. Time is short, so I will be brief. When I talk about symbolic sanctions, again, I am talking about sanctions specifically using the financial system and access to the dollar. Other forms of sanctions are not part of the discussion that I provided today.

An example I would use would be sanctions that were used to target Carrie Lam and other officials in Hong Kong in 2020. I was as upset as anyone about what was happening there. But in that case, it is very unlikely they are going to change Xi Jinping's behavior and plan for Hong Kong. And the effect is that it raised alarm bells in Beijing about the United States' willingness to use sanctions against China, which I think has sort of precipitated fur-

ther steps from the Chinese to again build up the resilience to a future event where we may need sanctions in a moment where our security is critically at risk.

Chairman LUETKEMEYER. The gentlelady's time has expired. With that, we will go to the gentleman from Pennsylvania, Mr. Meuser, for 5 minutes.

Mr. MEUSER. Thank you very much, Mr. Chairman. And thank you all for being here. We are having a serious discussion on the economy because we have some serious issues. The present Administration policies are weakening our economy through excessive spending and the value of the dollar which causes inflation, energy policies that are causing energy to spike and maintain a level of stagflation perhaps; a Fed reaction that was overdoing it with stimulus, followed by the most-rapid increase in interest rates we have ever seen. And, of course, the threat of taxes on American businesses, which is pretty much the worst thing you can do and gives nothing but an advantage to China.

Meanwhile, China is strengthening. It has RMD incentives, more engineers, strategic alliances, low-cost production, and workforce availability. So, we need to get into shape. We are getting ourselves out-of-shape, and we need to be serious about being the strongest economy in the world.

Mr. Billingslea, I would like to start with you. Do you think reversing some course here where we rein in spending, i.e., curbing inflation, create some predictability to future taxes, and have an independent energy program, will be steps in the right direction?

Mr. BILLINGSLEA. I do, and it would certainly help my investment portfolio. But more to the geo-strategic point here, because of what the Biden Administration has done on energy, we are seeing that our efforts to go after Putin are not being successful because we have been unwilling to actually sanction his oil exports.

The Biden Administration has actually issued a license that explicitly permits all of those sanctioned banks—it is still fine to transact with them as long as it is related to energy exports, because they don't want to see the price at the pump go up, but they are not willing to allow the exploration and production necessary to bring the price of the pump down through American energy.

Mr. MEUSER. Sure. And it's a huge cost to the typical American family and business.

Mr. BILLINGSLEA. And to the Ukrainian people who are suffering from the fact that the war machine in Russia keeps going.

Mr. MEUSER. Agreed. I have a bill, the China Exchange Rate Transparency Act, which would require the U.S. Executive Director of the International Monetary Fund (IMF) to advocate for enhanced transparency and surveillance of the People's Republic of China's exchange rate arrangements. Do you think this level of transparency is something that would make an impact, would make a difference? And are we doing enough to maintain, to keep China following the rules all of the other IMF nations are following? Mr. Billingslea?

Mr. BILLINGSLEA. I would have defer to my colleagues, sir. I actually haven't had a chance to read your bill, but I would be happy to take a look at it.

Mr. MEUSER. Please, Mr. Faulkender, I would appreciate it.

Mr. FAULKENDER. I would reiterate something that was said earlier, which is that the Biden Administration should yet again label China as a currency manipulator and once again take steps to mitigate some of those impacts, some of the things that we did during the Trump Administration in our trade administrations to punish them for not only the intellectual property theft and the forced technology transfers, but also their currency manipulation. And I think we need to take a much harder line on reining in some of the manipulation they are doing.

I don't know whether the IMF is the best way to do it versus doing it through bilateral activities in multilateral sanctions, but certainly, there needs to be at least a relabeling of them as a currency manipulator.

Mr. MEUSER. That is one of many actions that probably need to be taken.

Mr. Faulkender, my colleague, French Hill, introduced the 21st Century Dollar Act. Could you speak to how requiring the Treasury to develop a real strategy to strengthen the dollar would help set a clear path for Congress, moving forward?

Mr. FAULKENDER. Absolutely. As I mentioned in my opening remarks, the Treasury Secretary, more than anyone, has a responsibility for ensuring that the dollar maintains its status as the world's reserve currency. So, Treasury should be at the forefront of the intersection of the three things that Congressman Hill's bill speaks to, which are upgrades to the payment system, fiscal responsibility, and appropriate use of sanctions.

I think the Treasury needs to take a much greater role as the steward of American debt to help guide us towards a path towards fiscal responsibility, but we also need to make sure that we create a regulatory sandbox of where financial innovation and technology investments can take place, but find the balance between speeding payment implementation with the national security anti-money laundering statutes that we have.

Mr. MEUSER. Okay. I have limited time here.

Mr. Billingslea, you mentioned how the dollar is not under short-term threat but is under long-term threat. So as a follow-up to this hearing, maybe you could send me something on what you think should be done, what Congress can do over the longer term. I yield back, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time has expired. The gentleman from Illinois, Dr. Foster, is recognized for 5 minutes.

Mr. FOSTER. Thank you. Many of the witnesses here have emphasized the advantages that the American consumer gets from having a strong U.S. dollar. And over the last 40 years, without exception, the U.S. dollar has strengthened under Democratic Administrations and weakened under Republican Administrations.

This is the data here, which is a pretty impressive plot. And I will just read you the actual number—the United States dollar weakened by 2.2 percent under President Reagan, and another 1 percent under President Bush.

It then strengthened by 18 percent under President Clinton and weakened by 24 percent under President George W. Bush. It then strengthened by 13 percent under President Obama, and weakened by 10 percent under President Trump. And the last time I made

this plot, it would have been up about 12 percent under President Biden. So, this is a pretty impressive correlation.

I was wondering what the witnesses' thoughts are on what is driving them? Is it simply the fact that the international community has a lot more confidence in the U.S. economy when Democrats are running it? Is there a pattern that we see here of Republicans getting the keys to the car, sending it into the ditch, and then Democrats have to go dig it out and get it moving again? What are the things that are responsible for that really impressive correlation? Any thoughts on that? I will just go left to right.

Mr. GOODSPEED. I think that there are many factors that influence foreign exchange rate movements that don't boil down to political cyclical factors, but rather asynchronous, monetary policy tightening.

In recent years, in 2018–2019, the Federal Reserve was engaged in quantitative tightening and was raising interest rates, while Europe, Japan, and the United Kingdom were continuing quantitative easing and low——

Mr. FOSTER. So, you would argue that it was just an accident, that without exception, it is always with every Democrat?

Mr. GOODSPEED. It is also a function of budget deficit. Typically, if we are having to borrow more, that means yields on government debt here are going to be higher. That is going to——

Mr. FOSTER. Okay. So Republican tax cuts, for example, would be one of the things that would weaken the dollar or actually maybe——

Mr. GOODSPEED. Insofar as they contributed to larger deficits, that would actually increase the dollar. Because deficits can——

Mr. FOSTER. If we can go down the line, any other thoughts on what the reason for this might be?

Mr. FAULKENDER. I have not yet studied the data. I am happy to respond for the record and look into the timing of when it took place and try to factor out what were the policy decisions versus what were the other factors, but I would be hesitant to speak to six data points and try to claim, on the fly, a causation.

Mr. FOSTER. Okay. Yes, so if you can all follow up for the record on that. I think it is a pretty powerful correlation, and we have to understand it. And also, as someone who started a manufacturing business that exports a good fraction of what we manufacture, this is a double-edged sword when people complain about currency manipulation, which is artificially depressing the value of your currency.

So, it is not a clean win. Some business sectors win and some lose when you have a strong or weak dollar. But it is my feeling that as much as anything, it is a statement about the confidence that the rest of the world has in the way Democratic Administrations take their responsibility seriously.

Dr. Goodspeed, thank you for your service on the Council of Economic Advisers for the last President. But last month your former boss, President Trump, urged Republicans to do a default as part of their budget negotiating tactics. Is this a policy that the Trump White House Council of Economic Advisors considered or endorsed during the times of Republican control?

Mr. GOODSPEED. If I recall from the town hall, I don't think he urged them to default. And to answer your question, no, it was not something we considered or recommended in the Council of Economic Advisers.

Mr. FOSTER. Okay. Let's see, previously, President Trump had suggested that the entire national debt could simply be retired by a one-time wealth assessment on multimillionaires and billionaires. First off, is this even feasible in the sense that is there enough money in the top fraction of a percent to completely retire the national debt?

Mr. GOODSPEED. Not to my knowledge.

Mr. FOSTER. Some of you have these numbers. I think it is pretty clear there is. It may or may not be a good idea, but roughly, the majority of wealth is held by people with net worth over $10 million, which is roughly the top 10 percent, I believe.

Mr. FAULKENDER. If you look at the paper wealth, the wealth on paper of the U.S. economy anyway, market capitalization is about $80 trillion, which, as you said, is in excess of $30 trillion. But understand that operationally, you would then have to liquidate simultaneously $30 trillion worth of financial assets. And when you did so, the market impact is going to crush the economy and you would not help——

Mr. FOSTER. Sure. I don't think it is a serious short-term solution.

Mr. FAULKENDER. No, it is not feasible to do so.

Mr. FOSTER. But it would be something you would do over time. Thank you. I yield back. I look forward to responses for the record on the——

Chairman LUETKEMEYER. The gentleman's time has expired. We will go to the gentleman from Georgia, Mr. Loudermilk, for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman. And thank you all for being here and sharing your time and knowledge with us.

Mr. Billingslea, in your response to Chairman Luetkemeyer's question earlier in the hearing, you expressed concern with the convertible gold-backed Chinese yuan. I wanted to follow up and ask if you would elaborate further on whether a gold-backed yuan would possess more credible threat to the dollar than the BRICS' common currency?

Mr. BILLINGSLEA. Thank you, sir. Basically, what I mean by that, is they have not done that. But the world wants relatively safe, stable investments. And that is what the dollar represents, but that is also what gold represents. The yuan does not currently represent that.

Mr. LOUDERMILK. Okay. Thank you for that. What about the risk of long-term bilateral trade agreements between China and emerging countries? Does the idea that China would use multilateral international agreements like BRICS' common currency conflict with what we know about their preference for deliberate piecemeal strategies.

Mr. BILLINGSLEA. Would you like me to respond to that?

Mr. LOUDERMILK. Yes, yes, I'm sorry.

Mr. BILLINGSLEA. Sure. The BRICS are countries—India being an exception in that—that are autocratic or otherwise have very

hostile opinions of the United States, especially Russia and China. So, I think we need to understand that they are working at cross purposes with us on a full range of issues.

What we need to be very, very careful on, and where we, I think, have perhaps taken a major step backwards is allowing China to insert into the Persian Gulf and what they are doing with the Saudis, in particular. They want guaranteed access to Saudi oil in the event of a crisis. And that is what they are up to in brokering those relationships.

Mr. LOUDERMILK. Okay. I appreciate that. I think that China would want significant control over common currencies, and we have to be very vigilant.

Another question, Mr. Billingslea, how have BRICS and BRICS-aligned counties responded to the de-SWIFTing of Russia following the Russian invasion of Ukraine?

Mr. BILLINGSLEA. They don't like it, because they can see it being done to their banks in a crisis, but they don't currently have much of an alternative. Because of the dominant role that the dollar plays, whether it is 200 percent or 100 percent, it is still the dominant trading currency. SWIFT is, for the time being, the only game in town.

Mr. LOUDERMILK. Okay. I appreciate that. What risk does the excessive use of de-SWIFTing as a sanctions alternative pose to U.S. dominance in the global financial system? Anybody can answer that.

Mr. MCDOWELL. I think, again, the demonstration of U.S. control over the actual flow of dollars, of communication, absolutely provides information to adversaries to prepare for events where they may face similar circumstances.

And I think what we are seeing is China, Russia, and other countries trying to create alternative payment networks. Russia has its own SPFS payment messaging system. It is quite small. It was launched in 2014, coincidentally, not coincidentally, after the initial round of sanctions starting in Russia.

In terms of CIPS, China's cross-payments network, Belarus joined and announced it was having banks join immediately following the 2022 sanctions.

So, what I am saying is there is a pattern between when the United States mobiles control over the pipes and the messaging of cross-border statements, and adversaries looking for alternatives. It doesn't mean they are using them, but they are getting plugged into the system as at least sort of a rainy-day option in the event of a future target.

Mr. LOUDERMILK. Thank you, Mr. McDowell. While I have you, what standards of scrutiny would you recommend Congress or the President consider before leveling sanctions on a country like China?

Mr. MCDOWELL. I think with China, again, I look at China not just as a typical country, because I think they are an alternative service provider. Most countries fall into alternative service users. They are looking for an alternative to the dollar.

China, and you could perhaps put Europe in this as well, are the only two sort of economic blocks capable, I think, of constructing an attractive enough cross-border statements network that could

attract those alternative service users that are looking for that network.

And that is why I think, again, with China there should be a higher bar of scrutiny. It doesn't mean sanctions would never be appropriate against China. We can talk about circumstances where they would be very appropriate.

But I think for smaller bites at the apple, it may not be worth the risk of sort of spurring China to move forward and build that alternative network, if that makes sense.

Mr. LOUDERMILK. Yes. Thank you very much. And, Mr. Chairman, I yield back.

Chairman LUETKEMEYER. The gentleman yields back. The gentleman from California, Mr. Vargas, is now recognized for 5 minutes.

Mr. VARGAS. Thank you very much, Mr. Chairman. Again, I thank you and the ranking member for holding this hearing. I also want to thank the witnesses. I, too, think that this has been an excellent hearing.

Dr. Faulkender, you have mentioned the interest rate in the United States. Has the inflation rate been higher or lower in the U.K. and the E.U than in the United States?

Mr. FAULKENDER. Inflation——

Mr. VARGAS. Has it been higher or lower?

Mr. FAULKENDER. Inflation immediately following the pandemic was originally higher in the United States, and then ultimately became higher in Europe. But it started here and was higher here first.

Mr. VARGAS. So it started higher here, then it was higher in Europe. Is it higher in Europe now, or is it higher here?

Mr. FAULKENDER. It is currently higher in Europe.

Mr. VARGAS. How long has it been higher in Europe?

Mr. FAULKENDER. We peaked at 9 percent in early 2022. They peaked a little higher than that, later than that. So, it has been about a year, if I recall correctly.

Mr. VARGAS. I think it has been longer that they have been higher than us.

Mr. FAULKENDER. Yes.

Mr. VARGAS. If you go back and look, because I know it has been more than a year.

Mr. FAULKENDER. It was right around the Russian invasion of Ukraine in February, so, I guess, a year and 4 months.

Mr. VARGAS. It is interesting because you keep blaming the Biden Administration tangentially for inflation. You don't mention that this is a worldwide inflation problem because of COVID and also because of, obviously, the war in Ukraine. You keep saying it is because of the spending of the United States. Well, the spending of the United States is not causing inflation in Europe. But anyway, I will move on to my next question.

The interesting thing is you all talk just about cuts and not that we are spending too much, but not about money, not about bringing more money into the system, taxes, in particular. What were the taxes under President Eisenhower? What was the highest marginal tax rate? Does anybody know?

Mr. GOODSPEED. I believe before the Kennedy tax cuts, the top marginal rate peaked in above 90 percent. Although, that was not a rate that anyone really paid.

Mr. VARGAS. Under President Eisenhower, I think it was 91 percent. In fact, interestingly, President Kennedy ran on lowering taxes. And, in fact, he wasn't able to because he was murdered before he was able to do that.

It was President Lyndon Johnson who actually brought it down to 78 percent. But the interesting thing was they really were worried about the debt. They really didn't want to pay it back. They didn't want to put it off on future generations. They didn't want to put it off on the poor.

So, they paid higher taxes. Their effective rate was much higher than it is today. But, again, they paid their taxes. You all just look at cuts. You want the cuts on the poorest of people, but you are not looking at what the wealthy are paying. And I think that is very important.

I do want to ask another question—I am through with those questions—about crypto currency. It hasn't been brought up much today. What is the issue with crypto currency? Is that a danger to the dollar? Some of us know, obviously, it is very small at the moment, but it could increase to be a real problem. Why don't we start with you, Dr. Goodspeed?

Mr. GOODSPEED. Sure. First of all. I would say the 2017 tax law was a lesson in terms of lowering marginal rates and broadening the base, and the way we broaden the base is by limiting the State and local tax deduction and the mortgage interest deduction, which are two deductions that massively favor the highest-income earners in the United States.

In terms of crypto currency, as of yet, I don't see crypto currency being a safe liquid asset that would rival other U.S. dollar-denominated assets in terms of reserve currency and international currency appeal.

Mr. VARGAS. Dr. Faulkender?

Mr. FAULKENDER. On taxes, I would just merely mention——

Mr. VARGAS. Not taxes, we are on crypto currency——

Mr. FAULKENDER. ——the percentage of GDP that is captured in the form of taxes is the third-highest——

Mr. VARGAS. I am going to move on and reclaim my time. If you are not going to answer the question——

Mr. FAULKENDER. With crypto currency——

Mr. VARGAS. ——no, I am going to move on, thank you.

Mr. FAULKENDER. Crypto currency, sir.

Chairman LUETKEMEYER. The gentleman will either ask a question or allow your——

Mr. VARGAS. I asked a question, and he answered a different question.

Chairman LUETKEMEYER. The gentleman will either reclaim your time and go to another witness, or ask a question.

Mr. VARGAS. My time is continuing to run here, so I am going to have to——

Chairman LUETKEMEYER. You are going to continue to talk about it. You are recognized for the balance of your time to ask a question of the witnesses.

Mr. VARGAS. He was answering a question I already asked.

Chairman LUETKEMEYER. And you reclaimed your time and went back to go to another witness.

Mr. VARGAS. In fact, my time is almost over now since——

Chairman LUETKEMEYER. I will give you another 30 seconds.

Mr. VARGAS. No, that is okay. When I asked the question, they answered the question, and I didn't want them to go back to the question.

Chairman LUETKEMEYER. Reclaim your time.

Mr. VARGAS. No, go ahead, but I am going to yield back my time. I asked my questions.

Chairman LUETKEMEYER. The gentleman yields back. The gentlelady from California, Mrs. Kim, is recognized for 5 minutes.

Mrs. KIM. Thank you, Chairman Luetkemeyer, and Ranking Member Beatty, for holding this hearing. It is no secret that the CCP, under the authoritarian regime of President Xi Jinping, wants to displace the United States as the top economy in the world and counter the American Dream with the CCP's version of the China dream at the global stage.

The CCP is strategically undermining U.S. interests at every turn, as proven by their theft of valuable intellectual property and agreements with Russia to circumvent economic sanctions triggered by the invasion of Ukraine.

I am going to direct this question to Mr. McDowell. The Russian invasion of Ukraine has been ongoing for over 15 months, so what lessons should the United States Government take from how we utilize sanctions when assessing the possibility of a similar impending attack by the Chinese towards Taiwan?

Mr. MCDOWELL. Yes, thank you for that question, Congresswoman. I think the lessons we can take from the sanctions against Russia, I would say before the war and after, again, are that they provoke our adversaries to move into alternative currencies. In fact, they sort of require it, because targets cannot use the dollar system, so they are forced to move into other currencies.

We have seen, again, leading up to the war, Russia settling more trade with China in euros, settling more trade with China in yuan. We have seen that increase with the focus on the yuan, and then rubles after the invasion and the new rounds of sanctions.

And in one sense, that is a sign that sanctions are working. Because if sanctions are working, countries will have to move their activity away from the dollar. But it is also a sign that sanctions do not stop countries like Russia or China from participating in the world economy. There are limitations to how effective they can be.

And again, I think the bigger lesson here is in thinking about how to use sanctions in a way that doesn't provoke additional sort of infrastructure building that will weaken the effectiveness of those in the future.

Mrs. KIM. Thank you.

Mr. BILLINGSLEA. Congresswoman, may I offer three or four specifc things I think we need to learn from what did and didn't work? The first lesson is you can't make vague unspecified threats in the run-up to hostilities. You have to begin imposing consequences before the assault begins.

Lesson number two, you cannot piecemeal sanctions on banks when it comes to state-controlled autocratic systems because they simply use the non-sanctioned banks to get around it.

Lesson number three, you have to go after the thing that they export which is giving them the hard currency reserves to keep the war effort going. And we have not done that with regard to Russian oil. So those, I think, are three major deficiencies that we need to fix.

To the chairman's point earlier, I served as an Acting Assistant Secretary of Defense, and Deputy Under Secretary of the Navy, as well as Assistant Secretary of the Treasury. And I can tell you the Treasury does not sufficiently plan in advance for these kinds of consequences. We need to urge Treasury to come up with a serious game plan to go after the Chinese if we believe an invasion of Taiwan in imminent.

Mrs. KIM. Thank you. Thank you so much for both of your perspectives on that and the lessons that we can take from it. But we should all be troubled by the increase of central bank swap line agreements deployed by the People's Bank of China. According to a 2021 People's Bank of China (PBOC) report, it has swapped facilities with 40 countries with a combined capacity of almost 4 trillion yen, or about $570 billion.

And just a few days ago, Argentina, a country facing a deep currency devaluation and 109-percent annual inflation, announced a deal to renew its currency swap line with China and double the amount it can assess to nearly $10 billion. The PBOC justifies the swap lines as a way to force countries to utilize the yen as a method of exchange.

I want to ask you, Mr. Billingslea, instead of liberalizing its capital account and allowing the yen to be fully convertible into the currency exchange markets, the CCP has opted its increase into its bilateral swap line agreements to further internationalize its currency.

Is there anything that the United States can do to slow down or reduce adaptation of the PBOC's current swap lines?

Mr. BILLINGSLEA. Thank you, Congresswoman. I am not an expert on credit swaps, but we do have some experts here, so I will defer to my colleagues.

Mr. MCDOWELL. Quickly, my only reaction here is that the swap lines were initially pitched as a way to promote the use of RMD and trade settlement. There are some studies that show there is a slight increase in trade settlement in yuan when a country has a swap line, but they are not transformational.

Now, it seems like in the case of Argentina, they are being used more as a way to help these countries that have found themselves heavily indebted to Chinese state-owned banks and the Chinese government to effectively get access to RMB to save their dollar reserves. To be honest, the use of the swap lines from Argentina is actually a stronger symbol of the dollar's strength than the reliance of countries like Argentina on the dollar as a sign of the line strength.

Chairman LUETKEMEYER. The gentlelady's time has expired. With that, we go to the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I thank the ranking member as well. And I thank the witnesses. I concur with those who have indicated that your testimony has been stellar. I greatly appreciate what you have said, while I may not agree with all of what has been said.

It seems that in life, I have been relegated the duty to ask the most-sensitive questions. So, please forgive me for asking what will appear to be a super-sensitive question. But there's a reason for it. And please also carefully consider your answer, because you will be photographed. I have in my office answers that have been photographed to super-sensitive questions.

Here is a question: If you consider yourself as someone who is not a White male, someone other than a White male, raise your hand, please. If you are something other than a White male. I believe there has to be at least one hand. Thank you, Doctor, for raising your hand.

Let the record reflect that but one hand is up, and that is the hand of Dr. Carla—is it, "Norrlof?"

Ms. NORRLOF. I get all kinds of pronunciations, but it is, "Norrlof."

Mr. GREEN. Thank you very much. I am asking this question because Democrats can only have one witness, and you are the Democrats' one witness.

We are witnessing White male privilege. You are the beneficiaries of it. You didn't create it. You didn't cause it. Someone on the other side should have said: Guys, listen, these are all White men. This is super-sensitive. You see, they become very much touched by this kind of questioning. But it is because we don't do this, that the privilege continues.

Let me ask all of you, do you know women who could testify here today? If you do, raise your hand. Reluctantly, okay. Let the record reflect that all of the witnesses know women who could testify. Dr. Norrlof, I assume you know a woman who could testify other than yourself?

Ms. NORRLOF. Yes.

Mr. GREEN. Thank you. So, we have witnesses—women who are capable, competent, and qualified, who could do this. But the system continues as it is because there are people who are not sensitive enough to understand that this depiction of White men has an impact on society, has an impact on the little girls who look at this.

I regret to have to do this, and I don't blame any of you, but it has to be done. There will be a photograph in my office with but one hand up when I did ask that sensitive question.

Now, let's go on to something more conventional. Do threats of default have an adverse impact on the dollar as a global currency of choice? Do threats of default have an impact? If so, raise your hand. Raise your hand, please. Reluctantly so. Dr. Norrlof, do you agree? If so, raise your hand.

Ms. NORRLOF. I don't agree that threats—I do agree that defaulting would have adverse consequences.

Mr. GREEN. But you don't think that saying we should default would have any impact?

Ms. NORRLOF. I think it is mitigated by the dollar safe haven status.

Mr. GREEN. The dollar safe haven status? What is that?

Ms. NORRLOF. That means that in times of crisis, the dollar actually increases.

Mr. GREEN. Let the record reflect that all but Dr. Norrlof raised their hand indicating that threats of default can have an adverse impact. I mention this because we have a former President who regularly indicates that we should just let it default, which aids and abets those who are in the business of extorting, by the way. I don't agree with this. I think that the dollar has supremacy because people know that we won't default and they believe in it. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired. The gentleman from Tennessee, Mr. Ogles, is now recognized for 5 minutes.

Mr. OGLES. Thank you, Mr. Chairman. And I want to thank the panel, again, a very esteemed panel, for their great testimony today. And, again, I would say of our panels, this has by far been the one that I have most enjoyed. Although, we have had some great panels. Don't misread my comments.

But as we talk about the significance of the U.S. dollar, we have seen countries take actions to start to move away or perhaps diversify away from the United States economy, for example, the pact France has made with China and the yuan. And the Malaysian Prime Minister said there is no reason to continue to solely rely on the United States.

But yet, the dollar survived the Bretton Woods collapse, the launch of the European Union, the euro, the financial crisis. We have discussed the stability and the depth, and it really did diversify the U.S. economy.

But as we look to continuing to attract and continue to go really kind of remain the dominant predator in the currency space, Mr. Goodspeed, what other incentives are there for countries to continue to ally with the United States, and then, what do we need to do to continue to further those incentives?

Mr. GOODSPEED. I think first and foremost is to maintain a dynamic, large, growing economy. Because that constitutes a center of gravity within the global economy that people have to transact in dollars, they have to invoice in dollars, and the market for U.S. dollar-denominated debt remains, to say it again, the deepest and most-liquid in the world.

I would also say we have had some discussion of innovation in crypto currency, in payment systems, and we want to make sure that we have a regulatory framework in place that allows for that innovation to occur within the United States versus without. And I would also add that low and stable inflation is important for stability in the dollar, and that is why it is essential that we get inflation back to target.

Mr. OGLES. You mentioned inflation, and if you look at our current spending levels, that has obviously created inflation within the United States. It has also created inflation abroad, as was mischaracterized previously. So as we look at the current Administration, and we look at our debt levels, we are currently at roughly

$32 trillion. And we just added $4 trillion to $5 trillion over the next 2 years. What impact do you see on the horizon if we don't get spending under control?

It should also be noted that we don't have a revenue problem. Historically, revenues have only exceeded current levels to GDP a few times in recent history. So, spending is the issue, not revenue.

Mr. GOODSPEED. I will say it will over time, as deficits mount and as the debt burden rises above 100 percent—I think the Congressional Budget Office has it ending the budget window at about 119 percent of our economy. Then, we will probably observe an acceleration of diversification away from the dollar as a hedge.

Again, I don't see another single currency displacing the dollar as the major international currency or as the major reserve currency, but continued diversification.

Mr. OGLES. Mr. Billingslea, why would banning of the Allied Paid, the cuwala, and WeChat be vital to national security?

Mr. BILLINGSLEA. I'm sorry. I didn't catch the first part of that question.

Mr. OGLES. Why was banning some of the alternative payment systems, CCP payment systems, important and imperative for national security?

Mr. BILLINGSLEA. I think the CCP had a number of reasons for going after some of these. One, I think had to do with some concern, some legitimate concern that the People's Bank of China had, that they were providing credit in an unregulated fashion.

Some of it is a control mechanism, because Chairman Xi wants absolute and total control over the Chinese oligarchs as they are. So, I think those are actions that motivated him. And I defer to my colleagues on the effect for the U.S. economy.

Mr. OGLES. Any further comments?

Okay. As we move forward—and we are about out of time—and continue to see escalation from the CCP against Taiwan, what impact would that have on the global economy—not the U.S. dollar, but the economy? Anyone?

Mr. FAULKENDER. It would be catastrophic.

Mr. OLGES. Mr. Chairman, I yield back.

Chairman LUETKEMEYER. The gentleman yields back. The gentleman from Iowa, Mr. Nunn, is recognized for 5 minutes.

Mr. NUNN. Thank you, Mr. Chairman, and thank you to the ranking member for holding this hearing. I want to compliment you all for being here, based on both merit but also a long lineage of successful insight into the strength of the U.S. dollar on the global economy.

Now, it is my belief that we are not under immediate threat of the U.S. dollar being replaced as the world's reserve currency. However, there are developments here that I applaud this Congress for taking a leadership role in helping to drive.

So, Mr. Billingslea, I am going to begin with you, both in your defense service as well as at Treasury, in February of this year, the Office of Foreign Assets Control (OFAC) issued action against several Russian individuals and proxies accused of skirting with the most-aggressive, or at least so-called aggressive sanction regimes in U.S. history.

Can you please talk with us about how Russian individuals and defense firms like Rostec have been able to facilitate arms sales under this extreme sanction regime leveled by the President?

Mr. BILLINGSLEA. Congressman, some of the sanctions that this Administration has imposed have been effective. In particular, some of the actions taken against Russian oligarchs. Likewise, I think it is commendable that they have rallied the U.K., and the E.U., and even some Asian allies to further impose sanctions.

But overall, the sanctions imposed by the Biden Administration have not, in fact, been the strongest ever, as they have touted. They are riddles with loopholes and exceptions. We are in the process of allowing the Iranians to continue to cut billion-dollar deals with the organization which also is expanding the Russian nuclear weapon stockpile, for instance.

So, it has not been comprehensive. We need to go after the full set of banks across-the-board, and we need to go after Russian oil exports. Otherwise, it prolongs the war.

Mr. NUNN. I fully agree with you on that. I do. I compliment the fact that we have been able to work with our allies on this. The challenge, though, remains that there is a shadow network in which a lot of this is skirting U.S. sanctions, and we are losing the ability to control that.

Specifically, let's talk about one of these, the Minkoff network. It is beginning to chip away at U.S. foreign policy and the legitimacy of the U.S. dollar just the way you highlight it. Tell me how one of these networks operates outside the U.S. control system?

Mr. BILLINGSLEA. They do it in a lot of ways. Russia also partners with Hezbollah, for instance, inserting sanctions on both sides of that equation. And they use jurisdictions which don't have really truly effective anti-money laundering regulations. And here I am specifically talking about the Emirates, I am talking about Turkey, and we also see a lot interest in Venezuelan gold. The largest gold reserves in the world are in Venezuela.

And as I said earlier in my testimony, people love gold because it is anonymous. It is hard to trace. And you see those gold flows going up into Turkey, over to the Emirates, and then onward either into China, India, or Russia itself.

Mr. NUNN. So, what we just highlighted here is this idea that we are weaponizing a network.

Dr. McDowell, I want to speak to one of these points you brought up during your opening statement. When people talk about weaponizing currency, I would offer that it is a mistake to assume that currency is the weapon beyond the monetary means.

Really what we are talking about here is that currency is just a payload. The real weapon is the underlying rails, the networks of these currencies and their corresponding payments and economic activity are transmitted on. Countries, companies, consortia, they control the rail and ultimately wield this as a real economic power.

I would like to highlight here for the record the blockchain payment network developed by Rastian Russia hospitality. CIPS is a payment clearing settlement out of the Communist Chinese currency. In 2022 alone, we saw over $14 trillion in transactions through this network, in over 109 countries.

So, the question I have here is, can you elaborate on how China's development of the Cross-Border Interbank Payment System (CIPS) has facilitated an alternative payment network for clearing these settlements outside U.S. networks?

Mr. MCDOWELL. Sure. Essentially, what we are talking about here is a Chinese replication of the Clearing House Interbank Payments System (CHIPS) in the United States. And that is a system of correspondent banking accounts between hubs. These are big global banks to which thousands of smaller banks are connected and have shared accounts with, so if you think about when you move around the country in a free airplane, but you are connecting in a major hub, all of the smaller airports is sort of what we are talking about.

And CIPS has something like 70 direct participants—these are all Chinese state-owned banks that are at the core of the CIPS network. And they are connected to now around 1,400 indirect participants. Some of these are in China, but they are in over a hundred countries now. That doesn't mean that all of those banks are participating in it, but again, they are hooked up to the plumbing, so, essentially, it is a——

Mr. NUNN. Dr. McDowell, I agree, this is fantastic. I want to highlight this point between CIPS and cell, the Russian version of this, are they effectively isolating the United States out of this, and is it a threat to the United States?

Mr. MCDOWELL. I don't think it is a threat to the U.S., again, I think it is more a tool for China to improve its resiliency. It wants to have the plumbing in place so that if it gets caught in a Russia-like scenario, it already has that network, and if it needs to lean more heavily on it, it is already using it, but it is marginal right now.

Mr. NUNN. Thank you, Mr. Chairman. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired. We will now go to the gentlewoman from Texas, Ms. De La Cruz, for 5 minutes.

Ms. DE LA CRUZ. Thank you, Chairman Luetkemeyer, for holding this hearing today. Now, this hearing comes at a critical time when some academics and naysayers are spreading theories that dedollarization has begun, and that the beginning of the end has arrived for the dollar's dominant role as a global reserve currency.

I want to start off with some basic observations and questions for our witnesses. But before I do that, Mr. Chairman, I would like to submit for the record a recent report from Moody's Investors Service dated May 25, 2023, "Dollar dominance will persist for decades despite new challenges."

Chairman LUETKEMEYER. Without objection, it is so ordered.

Ms. DE LA CRUZ. Thank you, Mr. Chairman. And as our witnesses all know, the U.S. dollar enjoys a reserve currency advantage over competing foreign currencies, which provides benefits to the United States in several ways, including in trade, finance, and in financing our unsustainable debt.

In this report, the Moody's report, it concludes that despite the likely emergence of a multipolar currency system over the coming decades, the global financial system will still be led by the green-

back, because its challengers will struggle to replicate its scale, safety, and convertibility in full.

Mr. Faulkender, would you agree with this assessment?

Mr. FAULKENDER. I would. There is no other viable competitor out there immediately that has the depth of market, the international trade, and that other countries want claims against our future economy the way that our competitors would offer.

Ms. DE LA CRUZ. Thank you. Is there a genuine risk that the dollar could lose its reserve currency status in the short- to medium-term?

Mr. FAULKENDER. Not in the short- to medium-timeframe, but that doesn't mean we don't need the long term to address some of these challenges.

Ms. DE LA CRUZ. And, Dr. Goodspeed, would you agree with Mr. Faulkender's remarks, and could you expand on them?

Mr. GOODSPEED. Sure. And I would just like to note that there are a couple of figures floating around in terms of how big a share foreign exchange transactions are accounted for by the dollar—45 percent or 90 percent. It depends on what you are looking at. I tend to think that the ranking member's number of 90 percent is more informative because it tells us what share of transactions the dollar is involved with on either side.

I would echo Mr. Faulkender's remarks in terms of in the near-term, it is very hard to see a displacement of the U.S. dollar. You can't replace something with nothing, or you can't replace a reserve currency with the attributes of the U.S. dollar, with a reserve currency like the euro or RMB that doesn't share those attributes.

Over the long-term, we do need to address the risk that investors no longer view the U.S. dollar and U.S. dollar-denominated assets as the safest and most-liquid in the world.

Ms. DE LA CRUZ. Thank you, both. Switching gears, I would like to move to China and the yuan.

Mr. Billingslea, during your time at the Treasury Department, you dealt extensively with Middle Eastern countries, particularly Saudi Arabia. What do you make of Saudi Arabia's off-again, on-again flirtations with Chinese officials as reported by The Wall Street Journal last year regarding dominating oil contracts in the yuan?

Mr. BILLINGSLEA. I think it is a huge issue, but it is a huge issue because it actually reflects a massive miscalculation on the part of the Biden Administration when it comes to Saudis. You can't demonize the royal family and then go crawling back to them and asking them to increase oil production, and then demonize them again and ignore them.

Of course, you are going to see the Chinese step into the gap. And that is precisely what they have done in brokering normalization in the diplomatic guise between the Saudis and the Iranians.

The Chinese have one ambition here, which is to ensure that in the midst of a Taiwan invasion, their access to oil from Saudi Arabia will be unimpeded.

Ms. DE LA CRUZ. Thank you. With that, I yield back.

Chairman LUETKEMEYER. The gentlelady yields back. Our Members have all asked their questions. And with that, I would like to thank our witnesses for their testimony today. You all were fabu-

lous. Thank you so much for your time and your attention and your ideas and the discussions that we have had with you.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, this hearing is adjourned.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

A P P E N D I X

June 7, 2023

Testimony of the Honorable Marshall Billingslea
Before the Subcommittee on National Security, Illicit Finance, and International Financial Institutions
of the House Committee on Financial Services
June 7, 2023

Chairman Luetkemeyer, Ranking Member Beatty, it is a pleasure to appear before your Committee today to discuss how best to preserve the U.S. dollar's role as the global reserve currency, and to maximize the advantages that conveys in the national security space.

In recent months there has been an uptick in talk about "de-dollarization," much of it driven by foreign autocrats and leaders with interests that conflict with the United States; a prime example of this is Brazil's newly re-elected President, Lula da Silva, who has repeatedly called on developing countries to replace the dollar with other currencies.

At the outset I must say that – to paraphrase Mark Twain – reports of the dollar's demise are an exaggeration.

I hold the view, shared by many others, that there is little chance the dollar will be supplanted by some other currency any time soon. It is true that over the past twenty years the dollar's share of official foreign exchange reserves has decreased, from 78 percent down to around 58 percent. But it still overmatches all other reserve currencies, with the euro accounting for just 19 percent, and the Japanese yen for 5 percent. The Chinese yuan is just 2 percent, and nearly a third of that is held by Russia, which cannot now easily access Western "hard" currencies. In other words, the shift away from the dollar has been into dozens of smaller, Western currencies, not towards a single emerging competitor.

Moreover, according to the Bank of International Settlements, the dollar is still involved in 88 percent of all global trade transactions. Compare that to 7 percent for the yuan.

At its core, the reason the dollar remains so prominent is because ultimately the international monetary system wants safe, stable assets. Our country provides that in ways others cannot. We have a relatively open economy that remains the world's strongest, at one quarter of the global Gross Domestic Product (GDP). We allow the dollar to float and do not manipulate our currency the way some countries do, such as Communist China. Nor do we impose the kind of capital controls that China does, which restrict the outflow of currency and raise doubts about the convertibility of the yuan. Our Federal Reserve system is transparent, we also have a strong, deep Treasury market and – with a few odd exceptions – we have never defaulted on our debt.

As a result, our national currency is at the heart of global trade and the functioning of the international financial system. This is very much in our national security interest because, among other things, it enables the US to employ a wide range of financial and economic tools against bad actors. It also enables us to deter third parties from helping these actors evade our sanctions by holding their access to the dollar at risk, should they do so.

However, we nevertheless should remind ourselves that in the 16th century, the Spanish silver dollar was dominant, followed by Dutch florins in the 17th, and the pound sterling in the 18th centuries. The link between a nation's currency being the favored unit of trade account and that nation's relative political dominance on the global stage is clear.

And that is why leaders such as Lula, Putin, and Xi all aspire to undercut the role of the dollar as the global reserve currency, just as much as they aspire to erode the international security framework that we so painstakingly constructed after the Second World War. Ultimately, they see it as a way of displacing the United States as leader of the free world. In the nearer term, they see it as a way of eroding our ability to use finance as tool for safeguarding our national security.

In this respect, Xi Jinping poses the most serious threat. He has dictatorial control of Communist China, having purged all his main rivals – many under the guise of anti-corruption investigations. Xi has a vision of China as the dominant Middle Kingdom on earth, to which all other nations ultimately will pay tribute, and some

cultures, such as the Uyghurs, enslaved and eradicated. To that end, he has overseen a massive expansion in Chinese military capabilities, launched an unprecedented nuclear weapons build up to rival the United States (and Russia), and is ominously threatening invasion of democratic Taiwan.

It therefore should come as no surprise that he, via the People's Bank of China (PBOC), would like to undercut the dollar and establish the renminbi/yuan as a true international currency. It also should not be surprising that the Communist Party is taking active steps to "sanctions proof" China's economy to the best of their ability, learning several lessons from the international sanctions that have been applied on Russia after its further invasion of Ukraine.

In March of 2018, Russia began dumping ownership in US Treasury bonds, from $96 billion down to $15 billion. Russia also began buying large amounts of gold, becoming the fifth largest owner in the world (with 2,300 tons). We saw this happening at the Treasury. I cannot say that they were doing this back then in preparation for further aggression against Ukraine, but I can say they were doing this to lessen their exposure to US sanctions, and to give themselves a way of transacting with a commodity that is hard to trace.

Indeed, over the past year we have seen Russian entities conducting gold denominated transactions through Dubai and Turkey as a way of getting around sanctions.

China is now embarking on its own gold buying spree. I have not yet seen the data for May, but April marked the sixth straight month of Chinese expansion in its gold reserves, with the stockpile reaching over 2000 tons. At least, those are the official figures. I suspect the number is in fact far higher, and that they are concealing amounts generated by Chinese gold mining around the world; China is the world's largest gold producer and half of that is state-owned. China is also the world's largest gold importer, much of it not declared. At a minimum, the PRC is building up a war chest with assets that will be harder to touch through financial sanctions. But if China begins to back yuan contracts with gold, it also may remove a major impediment to the yuan being able to challenge the dollar by resolving concerns over convertibility.

This bears watching.

Last year China was also reducing its holdings in US Treasuries. 2022 marked the second largest decrease on record, with a drop of ~$174 billion, and China stood at the lowest level since 2010. But it seems to have reversed course this past March, perhaps temporarily. So far, while reducing its exposure, China has not yet moved decisively away from dollar debt the way Russia did. In fact, it seems that between 50-60 percent of China's foreign exchange reserves are still in dollar-denominated assets, though China considers the exact composition to be a state secret. This also bears close watching because a significant sell-off may be a leading indicator of planned Chinese aggression.

Perhaps one area where Xi Jinping may be more sanguine over his ability to withstand US financial and economic measures, in event of conflict, is the sheer size of China's financial sector.

One of the first things that the Biden Administration did in the wake of Russian aggression was to start sanctioning Russian banks, albeit in a piecemeal fashion. But it is one thing to de-SWIFT banks in an economy smaller than that of Texas. It is quite another to try to do that to banks in China. In 2022, Russia had just one bank in the top 100 globally, ranked by total assets (at number 65). China today has 20, including the four largest. These four alone have nearly $20 trillion in assets, which is more than one sixth of the total amount held by all 100 of the world's largest banks.

That is why many within the US Treasury would contend, as they did when I was there, that certain Chinese banks are just too big to sanction. For this reason, and to ensure that we could sanction Chinese banks, if necessary, we need to take immediate steps to reduce both the direct and indirect exposure of our financial institutions and our investors. According to the Atlantic Council, Communist China has up to $5.8 trillion in liabilities to Western investors, or assets in China belonging to them. In comparison, China has around $3.4 trillion in international assets that could be targeted by Western sanctions. In other words, China could potentially hit back as hard as we can.

The market is already starting to react to the geopolitical tension caused by Chinese military provocations and bellicose rhetoric towards Taiwan, and is moving in the right direction. For instance, yesterday Sequoia Capital – a major technology startup investor – announced that it would be splitting away its Chinese business. Indeed, many other venture capital firms have started scaling back their investments in China. Additionally, since April, Chinese companies have lost around $540 billion in stock value. Most of the major Chinese indexes, like the Nasdaq Golden Dragon China Index (which follows New York-listed Chinese companies) are down between 3 to 6.5 percent, and the yuan has dropped 2 percent.

As the Atlantic Council pointed out, of the $5.8 trillion in Western investment that China can hold at risk, roughly half of it is in the form of dollar or euro denominated external debt, including some Chinese government bonds. Just as Russia decided to default or defer payment on its debts, China could do likewise. This could cause serious harm to some of our pension and investment funds. We need to look at ways to encourage portfolio managers to recognize this very real risk, and to take steps to mitigate it now – not after conflict is imminent.

We have also seen three of the biggest US banks trim their exposure to China by more than $9 billion between 2022 and the start of 2023. This is another area where Federal action will be helpful. To encourage further reduction, and to build a hedge against reciprocal sanctions, US financial institutions with significant China exposure should face increased capital requirements. We need to ensure that our largest banks can withstand the systemic shocks to the banking system that a sanctions war would entail.

Finally, China has built up mammoth forex reserves – more than $3.2 trillion as of April. In comparison, Russia had built up reserves of $630 billion before it attacked Ukraine. Even with half of its assets frozen overseas, the Russian Central Bank has been able keep the Russian economy functioning and its war machine going. The People's Bank of China will certainly not repeat Russia's mistake of leaving assets where they can be frozen. So, consider then what the People's

Bank of China will be able to do, in terms of sustaining its economy in the face of Western financial pressure.

China continues to run a significant current accounts surplus, exporting far more than they import. In 2022, the PRC shipped out nearly $3.6 trillion in goods, which was seven percent more than 2021. Of that amount, approximately $583 billion was sold to the United States. That is $148 billion more than when President Biden took office, a 34 percent increase over 2020. While it may be impossible to push China into a trade deficit, we at least need to reduce the size of its surplus. The larger that surplus, the larger China's foreign exchange reserves become, and the more prolonged will be its ability blunt the effect of Western sanctions in event of a Taiwan invasion.

In conclusion, because of the dollar's continued dominance as the global reserve currency, we do have enormous leverage over Communist China in the event of hostilities. But because of trade and investment decisions made over the past several decades, we face an adversary that not only is now the world's second largest economy, but which has a financial system that will be resilient in the face of sanctions. Just how resilient will depend upon what steps we take, starting now.

Chairman Luetkemeyer, Ranking Member Beatty, and Members on the committee,

Thank you for the opportunity to speak with you today on dollar dominance, federal fiscal mismanagement, and the implications for our nation's economy. I had the honor of serving as the Assistant Secretary for Economic Policy at the Department of the Treasury during the previous administration. In that role, I worked with Members on both sides of the political aisle and the Small Business Administration to quickly implement the Paycheck Protection Program and ensure that the economic devastation that might have resulted from the pandemic was not realized.

As Assistant Secretary, I told my team that the Treasury Secretary proudly states that the dollar will never not be the world's reserve currency and our job at Treasury was to make sure that it is always true. Maintaining that role means engaging in prudent economic stewardship, continuously upgrading the technology supporting the Nation's payment system, and showing restraint in our deployment of unilateral sanctions. Most importantly, we must demonstrate to the rest of the world that we are financially responsible by addressing our unsustainable fiscal path.

To understand why that is the case, we must start with the role of money. Academic literature has identified three purposes of money: (1) facilitate exchanges of goods and services, (2) serve as a store value from when the money is received until it is used, and (3) act as a unit of measurement.

Therefore, one reason the US dollar (USD) is the world's reserve currency comes from international trade. If contracts are settled in dollars, then banks that facilitate payment between international trading partners will want to have dollar denominated assets. According to recent work by the Bank for International Settlements (BIS), "[a]pproximately half of global trade is invoiced in USD, although this share varies widely across regions". Note that this is not because the US is a trading partner for all this trade – the US only accounts for approximately ten percent of global trade flows.

A number of countries also peg their currency to the dollar, meaning that their central bank intervenes in currency markets to keep the exchange rate between its currency and the dollar at a fixed rate. This brings greater stability to their trade with the United States, since it removes currency risk. A challenge this creates is that in order to maintain the peg, the foreign country usually must also adopt the interest rates of the US Federal Reserve, causing interest rate effects here to be exported abroad.

Even in countries whose currencies are not pegged to the dollar, their companies engaged in international trade for non-US involved transactions may invoice in dollars because they want a currency that is easily converted into their home currency and stores value in the interim. According to that same BIS study, "[a]t least 85% of trading in the spot, forward and swap markets features the USD in one leg of the transactions." Our financial markets, including for foreign exchange, are the most liquid markets in the world, meaning that transactions are implemented at low cost with fast execution and minimal price impact. Thus, part of maintaining our role as the world's most transacted currency means keeping our markets open and easily

accessible with ongoing improvements in technology that speeds order implementation while safeguarding against cybersecurity threats.

Arguably more important, the demand for dollar denominated trading arises because the value of the dollar has historically remained strong and stable over time. This is where fiscal and monetary policy play key roles. When economic growth is robust and domestic inflation is both low and consistent, the US dollar is stronger and less volatile, thus serving the important second role of money – as a store of value. However, when growth is stagnant and price increases are larger and more variable, dollar denominated assets do not well serve foreign transactors who are looking to mitigate currency risks in international trade. Therefore, a significant threat to dollar dominance arises from the combination of inflation and anemic growth, which results in too many dollars chasing too few goods and services.

During the COVID-19 pandemic, aggressive fiscal policy was essential to ensure that our nation's families and small businesses survived its devastation. However, by January 2021, the economy had nearly fully recovered from the impact of the pandemic – 84% of the lost output and 57% of the jobs lost from the recession had returned. In addition, three vaccines had been developed and their deployment to the American people was beginning.

Nevertheless, Congress and the Administration enacted an additional $1.9 trillion in federal spending, resulting in the highest inflation our nation has endured in forty years. Former Clinton Treasury Secretary Larry Summers characterized the economic policies of this administration as "the least responsible macroeconomic policies we've had in the last 40 years." Additionally, researchers at the San Francisco Federal Reserve published findings that stated, "Fiscal support measures designed to counteract the severity of the pandemic's economic effect may have contributed to this divergence by raising inflation about 3 percentage points by the end of 2021".

Even last year, well after the pandemic had ended, federal spending was still more than 24% of national output, significantly above the 20.3% average that existed between 1980 and 2019. The result is that the most recent version of the Financial Report of the US Government projects debt to be 566% of national output by the end of its 75-year forecast period, compared to approximately 100% today. These levels of deficits and debt erode confidence around the world that the US will continue being the responsible economic steward that earned us status as the world's reserve currency.

Now is the time for Congress to address our unsustainable federal budget. Given the recent, outsized role of the federal government in our economy, growth between Q4 2021 and 2022 was an anemic 0.9%. Inflation is still well above the Federal Reserve's two percent target such that the FOMC is considering further interest rate hikes. These inflation-induced interest rates have resulted in the second, third, and fourth largest bank failures in US history. The Index of Leading Indicators is in recession territory and the staff of the Federal Reserve is predicting a recession.

Yet the President insists on throwing more gasoline on the stagflation fire. Washington directed spending that replaces low-cost, reliable sources of energy with high-cost, unreliable

sources of energy simultaneously causes inflation and contraction. The regulatory onslaught of this administration is estimated to have added 231 million paperwork hours and cost our economy $368 billion, again raising prices and lowering output.

We must stop expecting the Federal Reserve alone to mitigate the inflationary impacts of fiscal and regulatory policy. The answer is not higher interest rates that would further undermine the banking system and erode the value of the dollar. Instead, we must reduce federal spending and rescind the regulations that are curtailing economic growth and devaluing the dollar. The Federal Reserve needs help from the Congress and the Administration if it is going to get us back to economic growth, price stability, and dollar dominance.

Continuing our existing fiscal policies will ultimately cause a bond market failure, irrespective of the actions of the Federal Reserve. The US economy can manage the current debt to GDP ratio but there is no consensus among economists on how much further we can viably indebt our nation. On our current path, the forecasted debt level and accompanying money printing will eventually create a crisis of confidence. Fewer international transactions will be traded in dollars. Foreign central banks will further reduce their holdings of dollar-denominated securities, causing interest rates to skyrocket and a loss of dollar dominance in international trade.

Policymakers must return to the responsible fiscal stewardship that made the U.S. the premier economic and financial nation in the world. We must return spending to its historical levels and not crowd out the private sector ingenuity and dynamism that ultimately improves standards of living for our fellow citizens. The American people deserve the opportunity to once again realize the shared prosperity that comes from greater economic growth with low inflation, higher wages, and more control over their own lives. Policies that continue dollar dominance contribute to realizing those outcomes.

I look forward to participating in this important conversation.

Testimony of Dr. Tyler Goodspeed before the U.S. House of Representatives Committee on Financial Services

To:	Members of the Committee on Financial Services – Subcommittee on National Security, Illicit Finance, and International Financial Institutions
From:	Dr. Tyler Goodspeed
Date:	June 7th, 2023
Subject:	Subcommittee Hearing entitled, "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency"

Chairman Leutkemeyer, Ranking Member Beatty, and Members of the Committee:

Thank you for the opportunity to testify before you today on an issue of long-run importance to the U.S. economy.

I am a Kleinheinz Fellow at the Hoover Institution at Stanford University and Chief Economist at Greenmantle LLC, a global macroeconomic and geopolitical advisory firm. From 2017 to 2021, I had the privilege to serve on the President's Council of Economic Advisers as Senior Economist, Chief Economist for Macroeconomic Policy, Member, Vice Chairman, and Acting Chairman.

In 2022, 88 percent of all foreign exchange transactions, by value, involved the U.S. dollar.[1] 59 percent of all official foreign exchange reserves were held in U.S. dollars, down from 71.5 percent in 2001.[2] By comparison, 31 percent of all foreign exchange transactions, by value, involved the euro—the second-most commonly transacted currency—which accounted for 20 percent of official foreign exchange reserves.

The fact that nearly 90 percent of all foreign exchange transactions continue to involve the dollar, and that global central banks continue to hold almost 60 percent of their foreign exchange reserves in the form of dollars confers net economic benefits on the U.S. economy.

First, foreign demand for reserves of U.S. dollars raises demand for dollar-denominated securities, in particular U.S. Treasuries. This effectively lowers the cost of borrowing for U.S. households, companies, and federal, state, and local governments. It also means that, on average, the United States earns more on its investments in foreign assets than it has to pay on foreign investments in U.S. assets, which allows the United States to import more goods and services than we export.

Second, foreign demand for reserves of U.S. dollars and dollar-denominated assets raises the value of the dollar relative to what it would be if the dollar were less prominent in foreign exchange transactions and central bank reserves. A stronger dollar benefits U.S. consumers and businesses that are net importers of goods and services from abroad.

Third, large reserve holdings of U.S. currency abroad in effect constitutes an interest-free loan to the United States.

[1] Bank for International Settlements, *Triennial Central Bank Survey* (2022).
[2] International Monetary Fund, "Currency Composition of Official Foreign Exchange Reserves" (2023).

Fourth, the denomination of the majority of international transactions in U.S. dollars likely modestly lowers the exchange rate risks faced by U.S. firms.

Fifth, given the volume of foreign U.S. dollar holdings and dollar-denominated debt, monetary policy actions by foreign central banks generally have a smaller impact on financial conditions in the United States than actions by the U.S. central bank have on financial conditions in other countries.

However, the benefits of the U.S. dollar's global reserve status are not without costs. Though lower interest rates in the United States benefit U.S. borrowers, especially the federal government, they also lower returns for U.S. savers.

In addition, though a stronger dollar benefits U.S. consumers and businesses who are net importers of goods and services from abroad, it also disadvantages U.S. firms that export goods and services abroad, as well as U.S. firms that compete against imported goods and services.

Furthermore, the perception of U.S. assets as a relative safe haven means that demand for the dollar and dollar-denominated assets tends to rise substantially in response to adverse macroeconomic shocks that are global in nature. As a result, the competitiveness of U.S. exporters and U.S. firms that compete against imported goods and services are likely to face an increased competitive disadvantage at times of elevated macroeconomic stress and adverse business conditions.

Despite these costs, studies generally find that the economic benefits of the dollar's prominent global status outweigh the costs, providing a modest net economic benefit to the United States. This does not include the benefit to the United States of the dollar's centrality in global transactions allowing the United States to utilize financial sanction tools, when appropriate, in support of national security objectives.

There are economic policies that would help to preserve this net economic benefit. First, prudent fiscal policy would help to ensure that U.S. government debt continues to be the most liquid and perceived as the safest in the world. Second, economic policies that enhance potential economic growth would help to ensure that the U.S. economy remains the largest and most dynamic in the world, and thus that demand for U.S. dollars for transactions purposes remains robust. Third, avoiding excessive levels of regulation would allow for continued financial innovation to occur within the U.S. financial and payments systems rather than outside them. Fourth, restoring low and stable inflation would reinforce the dollar's status by restoring stability in the value of the U.S.

I look forward to your questions and participating in this important economic issue.

Daniel McDowell
Written Testimony
House Financial Services Committee
National Security, Illicit Finance, and International Financial Institutions Subcommittee
Hearing entitled "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency."
June 7, 2023

Chairman Luetkemeyer, Ranking Member Beatty, distinguished members of the committee, it is my honor to be speaking with you today about preserving the US dollar's status as the world's preeminent international currency. I would like to open with my bottom-line up front: As the United States has increased its reliance on financial sanctions as a tool of foreign policy, it has provoked anti-dollar policy responses from our adversaries. Though such steps are unlikely to upend the dollar's position as top international currency, including the reserve role, over time such policies could diminish the coercive capabilities that the United States derives from dollar centrality.

Though our Republic has never been ruled by a monarch the US dollar has become a powerful symbol of American *financial* royalty. Indeed, the dollar is often described as the "king" of all currencies, and rightly so. Across the full spectrum of international roles that a national currency can play—the reserve currency role, cross-border payments and trade settlement, turnover in foreign exchange markets, and so on—America's currency outcompetes all comers and, presently, lacks a true rival in this space.

Dollar preeminence and US financial centrality are not without consequence for American coercive power. With little more than the stroke of the president's pen, or through an act of Congress, the US government can use financial sanctions to impose enormous economic costs on targeted foreign actors—be they individuals, firms, or state institutions—by freezing their dollar assets, or cutting them off from access to the banks through which dollars flow. The consequences for individual targets, known as Specially Designated Nationals or SDNs, are severe, significantly impairing a target's capacity to participate in international trade, investment, debt repayment, and depriving them of access to their wealth.

Over the last two decades, the United States has used the tool of financial sanctions with increasing frequency. For example, in the year 2000, just four foreign governments were directly targeted under a US Treasury country program, overseen by the Office of Foreign Assets Control (OFAC). Today, that number is greater than 20. If we include penalties from secondary sanctions, the list gets even longer.

The more the United States has reached for financial sanctions, the more it has made adversaries in foreign capitals aware of the strategic vulnerability that stems from dependence on the dollar. Some governments have responded by implementing anti-dollar policies—measures that are designed to reduce an economy's reliance on the US currency for investment and cross border transactions. Though these measures sometimes fail to achieve their goals, others have produced modest levels of de-dollarization.

Notable examples include Russian steps to cut its dollar reserves and reduce the use of the dollar in trade settlement in the years leading up to its full-scale invasion of Ukraine, or China's ongoing efforts to build its own international payments network based on the yuan—efforts that have taken on a new sense of urgency as Beijing has become more aware of its own strategic vulnerabilities from dollar dependence.

To be clear, I do not believe that geopolitically motivated moves by Russia, China, or any other country, gravely threaten dollar supremacy. The dollar remains the world economy's indispensable currency and maintains economic and political advantages over all alternatives. However, the growing number of states espousing anti-dollar viewpoints and adopting anti-dollar policies does threaten to weaken the future potency of US financial sanctions.

I will conclude my remarks with three suggestions for US sanctions policy moving forward, aimed at protecting the dollar's status and preserving the tool's effectiveness for moments when US interests are most gravely threatened.

First, the United States should reconsider the use of so-called "symbolic" financial sanctions. That is, if the main objective of a tranche of sanctions is to signal to the world or a domestic audience that Washington disapproves of a foreign government's policy choices, other measures that send a similar signal but do not politicize the dollar system ought to be considered first.

Second, the use of financial sanctions against issuers of potential rival currencies—in particular China and its yuan—should face a higher bar of scrutiny. Even a small, targeted sanctions program provides information to our adversaries about their vulnerabilities and gives them time to prepare for a future event when a broad US sanctions program may be called upon as part of a major security crisis, when such measures will be most needed.

Finally, whenever possible, US financial sanctions should be coordinated with our allies in Europe and Asia, who should feel as if they are key stakeholders in the dollar system, not vassals to it. Such coordinated efforts will prevent our friends from seeking to conduct business with US adversaries outside of the dollar system and send a message to the world that moving activities into secondary currencies like the euro or yen is not a safe haven.

It is my privilege to be here today and speak on this critically important issue. I am happy to take your questions.

Subcommittee on Financial Institutions and Monetary Policy of the House Committee on Financial Services

Dollar Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency
Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency

June 5, 2023

Dr. Carla Norrlöf
Nonresident Senior Fellow, GeoEconomics Center, Atlantic Council,
Professor of Political Science, University of Toronto

Dear Committee Members, thank you Chairman Luetkemeyer and Ranking Member Beatty for inviting me to testify on the important topic of dollar dominance and the preservation of the dollar's status as a global reserve currency. I am honored.

Introduction

Despite numerous challenges, dollar dominance has persisted for nearly 80 years. Why does the dollar continue to play such a prominent role, is the dollar likely to reign supreme over the long term, what are the most important threats on the horizon?

The extent of US dollar dominance and its preservation has become a principal theater for the great power struggle between the United States, China and Russia placing the future of liberal international order in the balance. The dollar is the only truly global currency in the world, and is widely used for transactions, pricing, settlement and investment by governments and private actors outside the United States. These roles offer the US economic, political and social privileges. Economically, Americans benefit from the ease and convenience of transacting in dollars, from seignorage, monetary flexibility and safe-haven benefits in times crisis. Politically, the dollar offers the United States a non-military instrument of coercion with which to police international order. Socially, the United States gains status and prestige. Preserving the dollar's status as the global currency is therefore in the United States' interest, and potentially in other countries' interest.

Dollar dominance refers to the disproportionate use of dollars in the world economy, a condition which has prevailed during the entire postwar era. The absolute dominance of the dollar is unlikely to change in decades to come, though the dollar's relative dominance has receded from peak levels. Even though the dollar remains dominant, a relative weakening of the dollar's status is considered a harbinger of the long-term power shift to the east, hastening the onset of a multipolar order in which the United States is less capable and less influential.

Assessing dollar dominance …

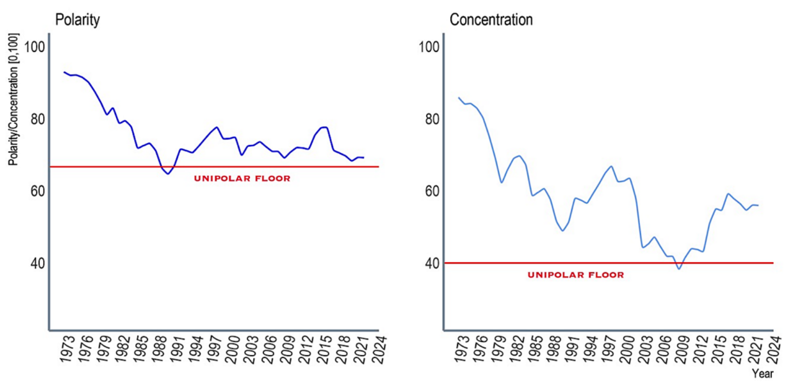
The precise meaning of dollar dominance in this regard remains unsettled. How strong must the dollar be relative to other currencies used for international purposes for the international currency system to be characterized by dollar dominance—a question rarely tackled head on. The lack of a common focal point makes it very difficult to determine whether dollar dominance is truly threatened

and how to discern a multipolar currency system if, and when, one comes to pass. Using metrics over the various functions of an international currency, for example, the reserve currency function, it is possible quantify dollar dominance according to established criteria—for instance polarity or systemic concentration (see Figure 1).[1] Polarity is a term traditionally used by international-relations scholars to assess the international balance of power based on military might. But the concept is sometimes used to describe the international distribution of economic power. Polarity is particularly well-suited for characterizing the international currency system because great-power currency capabilities can be used to enforce international agreements and police international order.

Strictly speaking polarity is the number of great powers in the international system. In a unipolar currency order, one great power enjoys preponderance and has no close rival. In a bipolar currency order, two great powers predominate and have distant rivals. And in a multipolar currency order, more than two great powers wield relatively equal influence. Yet this still leaves open the question of how to measure polarity.[2]

Figure 1. Dollar unipolarity

Two measures of reserve currency hierarchy, 1973-2022



Source: Norrlöf calculations based on IMF COFER data

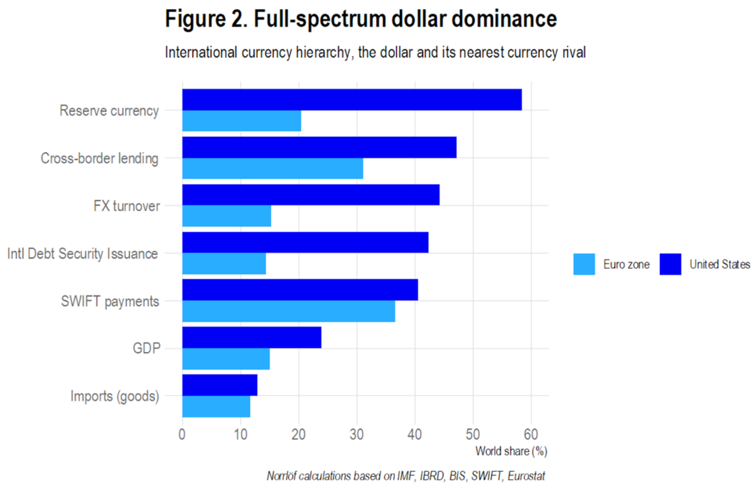
[1] Carla Norrlöf, 'Currency, Conflict, and Global Order', *At Arms,* PS Quarterly, New York, Summer 2023.
[2] To determine whether a system is unipolar, the left-hand panel in Figure 1 relates all the major powers accounting for 5 percent of currency reserves to the major power accounting for the largest share of currency reserves. A unipolar floor is drawn at a level where reserves in the leading currency are twice as large as reserves in other major currencies. This standard offers a clear-cut abstraction of unipolarity. Being twice as powerful as any counter-coalition clearly renders a balance of power impossible and thus creates stability by muting opposition. Unipolarity can also prevail without this exacting standard, as in the right-hand panel of Figure 1. Here, the unipolar line is based on system-wide changes in currency shares. A unipolar floor is drawn at a concentration index of 40. Below that point, the system no longer is considered unipolar, but rather bipolar or multipolar.

Over the course of half a century, the dollar's reserve currency role was strongest in the years following the collapse of the Bretton Woods dollar standard when President Nixon abandoned the promise to convert dollar reserves into gold –the 1971 Nixon shock. Regardless of which measure of dominance is used—polarity or systemic concentration—the dollar is significantly lower today than it was in 1973. However, the dollar's reserve currency role is stronger than it was in 1990 when the Cold War ended. In a fifty-year perspective, the dollar reached a low point at that time, a period otherwise considered to mark the onset of America's unipolar moment.[3] Clearly, the level of reserve currency holdings in a single year, or within a limited time frame, is not a good predictor of US ascendancy or decline in any broader sense. Point estimates of reserve currency holdings are not a good predictor of dollar dominance either. That is because the liquidity creating role, assumed by the issuer of the first international currency, requires adjustment of expansionary policies, resulting in cycles of trade deficits when demand for dollar assets is typically high and deficit adjustment when dollar demand tends to fall. Depending on the measure used to assess dollar dominance, the most recent downward dollar cycle began in 2016 (polarity) or 2017 (concentration). According to both measures, an upward cycle began in 2020 and stabilized despite the 2022 sanctions against Russia.

The dollar's many international roles

The dollar's reserve currency role is used synonymously with the dollar's ability to fulfill the range of currency functions—as medium of exchange, unit of account and store of value—for governments and private actors. This shorthand reflects the view that governments' willingness to accumulate dollar reserves is a condition for the longevity of the dollar system. For example, in times of crisis, when dollar shortages occur, private actors rely on their central banks to supply them with dollar assets, sometimes via swap lines extended by the Federal Reserve. Private actors' willingness to use and hold dollars is necessary for the dollar system's reach and entrenchment, but private entities coexist within a decentralized system. Their actions are not as consequential as those of official actors because each single entity typically holds a small slice of dollar assets. Even the considerable dollar assets held within large financial institutions consist of deposits by separate entities without any means or incentives to coordinate actions apart from inadvertently via the price mechanism. Unlike official actors, private actors' choice of foreign currency is exclusively an economic decision. Moreover, they are unlikely to act collectively with the aim of disrupting the system. As shown below in Figure 2, the reserve currency role is where the US has the biggest lead relative to its nearest currency rival, the euro-zone.

[3] Charles Krauthammer, 'The Unipolar Moment', *Foreign Affairs* 70:1, 1990.



How the dollar became dominant

The dollar rose to the top of the international currency hierarchy after WWI, superseding the British pound which regained its number one position in the interwar years before permanently losing currency primacy to the United States after WWII.[4] After WWI, devastated European countries began relying on the United States for loans to rebuild their war-torn economies. The United States gradually became banker to the world with New York emerging as a financial center on a par with London. The stock market crash of 1929 and the ensuing Great Depression hit the US hard, and the international role of the dollar declined between the two world wars. The 1944 Bretton Woods Agreement created a dollar-based system in which all currencies were pegged to the dollar and the dollar was pegged to gold, convertible at the rate of $35 an ounce. WWII decimated European industry, which the United States helped rebuild through the Marshall Plan with large-scale investments and merchandise exports to Europe.

The United States' strong economic lead after the two world wars, Europe's dependence on the United States to resuscitate its ailing economies along with the 1944 Bretton Woods agreement on the dollar-gold standard created the conditions for dollar dominance. Dollar primacy continued even as the United States broke away from the system which established the dollar's prominent role. The Bretton Woods system capped US trade deficits at levels compatible with the United States' ability to liquidate foreign dollar holdings through gold conversion. When the United States shook off the constraints reflected by gold conversion, the dollar system did not end. The 1971 Nixon shock simply decoupled the

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[4] Barry Eichengreen and Marc Flandreau, 'The Rise and Fall of the Dollar (or when did the Dollar Replace Sterling as the Leading Reserve Currency?)', *European Review of Economic History* 13, 2009.

dollar from gold and replaced the gold constraint on US trade deficits with inflation and dollar depreciation.

The role of trade & oil

The dollar's international role initially coincided with US trade surpluses as European countries absorbed American goods. As the European economies grew, demand for US assets grew, and the trade dynamic was reversed. US trade deficit pressures started to undermine the Bretton Woods dollar standard as predicted by the economist Robert D. Triffin.[5] In his testimony to the US Congress, Triffin pointed to the contradiction between the United States' liquidity provision and confidence in the dollar. The United States exported dollar assets, which were held abroad as foreign reserves, creating the liquidity needed to fuel economic growth. Dollar exports generated foreign investment in the United States leading to trade deficit pressures. In this case, the large supply of dollars undermined confidence in the dollar, particularly the United States' ability to honor dollar conversion into gold, potentially jeopardizing the dollar standard. On the other hand, had the United States not accepted to run trade deficits the main source of international liquidity would run dry, which risked undermining international economic growth with destabilizing consequences. The United States' liquidity provision was required for continued growth but in conflict with the long-term prospects of the dollar's international role. Triffin predicted the breakdown of the Bretton Woods dollar system, and the dilemma remains relevant for the relationship between the United States' liquidity creating role and confidence in the dollar. In the 1970s, oil and other commodities began to be priced in dollars, creating incentives for official and private actors to settle payments in dollars and therefore store value in dollars.

Threats to dollar dominance

The dollar remains dominant due to economic fundamentals and the history of using dollars, favoring future use because everyone else is using dollars. Supporting the dollar's international role are factors such as the size of the US economy, its commercial and financial markets (see Figure 2), the liquidity, depth, breadth and openness of US financial markets, the dollar's convertibility, relative stability and sound macroeconomic policies. The economic policies underpinning issuance of the primary international currency has not been flawless, but the historical record does not need to be perfect for the historical record to support the dollar's continued use. The network effects of plugging into the dollar system due to the liquidity, depth and breadth of the market for dollars creates an incumbency advantage, which is hard to overcome. In the absence of major economic or geopolitical upheaval, inertia disincentivizes a major switch to alternative currencies. Political factors could also impinge on the dollar's role. For example, strong political institutions and property rights protection contribute to shoring up confidence in the US economy. Security ties to the United States are also said to have favored dollar use in the early Cold War days. US sanctions to uphold the liberal international order invite dollar support from states backing the order. On the flip side, an erosion of US political institutions, a weakening or reduced need for US security guarantees, or alternatively a sanctions backlash would likely reduce dollar support.

Unless political developments within the United States, or US foreign policies, radically shake confidence in the United States and access to dollars, economic factors are more likely to determine the fate of the dollar system.

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[5] Robert Triffin, *Gold and the Dollar Crisis* (New Haven: Yale University Press, 1960).

US decline …

America's relative economic decline has been debated for at least 60 years. In the 1960s, Organski predicted China's inevitable rise as a systemic leader and noted India's likely emergence as a great power.[6] In the 1980s, Paul Kennedy famously predicted that the United States would lose the superpower competition with the Soviet Union due to military overstretch.[7] And an emphasis on competition in the era of economic interdependence led to repeated warnings about the United States' ability to maintain its edge over rising economic powers, notably Europe and Japan.[8]

The US has declined relative to other great powers along various dimensions but remains the absolute strongest power across most dimensions. China's GDP is nearly 80 percent of US GDP, and its goods imports are roughly equivalent to US goods imports. However, China's financial markets are nowhere near the size or sophistication of US financial markets and China's yuan accounts for less than 3 percent of foreign exchange reserves. The euro area is a closer competitor to the dollar. Euro area GDP is approximately 60 percent of US GDP, goods imports account for some 90 percent of US goods imports and euro area financial markets are both advanced and large. The euro is the second strongest reserve currency, accounting for approximately 20 percent of foreign exchange reserves compared to the dollar's 60 percent share.

US domestic economic policies

While the dollar enjoys an extraordinary lead over other international currencies, it is not invincible. Poor domestic policies could shake confidence in the dollar. Structurally, the United States' liquidity creating role, providing dollar assets to the rest of the world and the ability to invest in the United States can interact unfavorably with low savings in the United States, resulting in large deficits, rising public and, or private debt. Unlike the euro-zone, however, the United States does not face the prospect of involuntary sovereign default because the dollar is a convertible sovereign currency. The recent specter of US default, a possibility which arises periodically, is entirely voluntary and due to a self-imposed debt ceiling. In the United States, the upper bound of the debt limit is rather determined by foreigners' willingness to hold dollars, at worst resulting in inflation and depreciation. Although the United States cannot be forced to default, such an adjustment process may not be benign.

Geopolitical challenges

There have been few deliberate attempts to unseat the dollar as the first international currency. In the early 21st century, Iraq and Iran discussed switching oil pricing from dollars to euros with a view to reducing dependence on the dollar system, a response to US sanctions and interventions in the Middle East. More recently, an anti-dollar counter-coalition centered around the BRICs countries has emerged. The inclusion of China and Russia, and large emerging economies, presents a more potent challenge to dollar dominance than in the past. If sanctions backlash, or some other development, leaves other countries dissatisfied, the counter-coalition could grow and pose a more acute defiance against the dollar system.

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[6] A. F. K Organski, *World Politics* (New York: Alfred A. Knopf, 1968 [1958]).
[7] Paul Kennedy, *The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000* (New York: Random House, 1987).
[8] R. Rosecrance, *The Rise of the Trading State* (New York: Basic Books, 1986) Lester Thurow, *Head to Head: The Coming Economic Battle Among Japan, Europe and America* (New York: William Morrow, 1992).

Rising US public debt, high inflation and other key developments are unfolding in a strategic setting reminiscent of the Cold War environment. The most striking parallel is the return of great-power rivalries and policymakers' preoccupation with security concerns, which are taking precedence over economic efficiency. Fears about economic decoupling, deglobalization, and fragmentation abound. On the monetary front, the worry is that countries anticipating US sanctions will move preemptively to reduce their dependence on the dollar.

China and Russia have been especially energetic in pushing alternative currencies and building a multinational financial infrastructure for trade and investment in renminbi and rubles. For example, China's Cross-Border Interbank Payment System (CIPS) acts as a clearing house similar to the US Clearing House Interbank Payments System (CHIPS).[9] CIPS processes a mere 15,000 transactions per day, amounting to the dollar equivalent of $50 billion, whereas CHIPS processes 25,000 transactions per day, with a value exceeding $1.5 trillion. The CIPS initiative has nonetheless laid the groundwork to clear and settle more cross-border exchange in renminbi. When China launches a financial messaging system capable of working independently from the Society for Worldwide Interbank Financial Telecommunication (SWIFT), it will have its own complete, autonomous architecture for settling cross-border transactions denominated in its own currency.

For its part, Russia has already taken steps to bypass SWIFT, creating its System for Transfer of Financial Messages (SPFS) after its illegal annexation of Crimea in 2014. Russia's central bank claims that demand for SPFS has increased significantly since last year's full-scale invasion of Ukraine. At the time, however, the system had only around 400 users.

Still, owing to new payments infrastructure and various bilateral agreements, pursuing trade and investment in non-Western currencies has become somewhat easier. Russia and China have agreed to trade in renminbi; and, reviving the Cold War-era rupee-ruble mechanism, Russia and India were planning to trade in their own currencies following Russia's invasion of Ukraine. However, that effort was recently discontinued, with both countries settling on using the United Arab Emirates' dirham instead. All told, such use of alternative currencies by third countries remains small. While the renminbi is being used to settle a Russian investment in a nuclear-power plant in Bangladesh, other examples are scarce.

Governments are also making plans to move away from pricing oil in dollars, although the significance of this development is easily overstated. Oil may be one of the world's leading export products, but it ultimately accounts for a small share of global trade.

More broadly, because international currencies are, by definition, used by third countries, adopting a trade or investment partner's currency will not necessarily raise that currency's international role, even if it does reduce the greenback's relative role in cases where those transactions were previously denominated in dollars.

Those predicting the end of dollar hegemony also point to China's own use of bilateral swap lines to allow foreign central banks to acquire renminbi in exchange for their own currency. Making renminbi available to foreign governments is a prerequisite for its use by public and private actors, and the ability to act as lender of last resort in times of crisis is a key reserve-currency function.

[9] Emily Jin and Lizzi C. Lee, 'CIPS vs. CHIPS: China's alternative to the U.S.-dominated financial system | Live with Lizzi Lee', The China Project, New York, October 31, 2022.

China has also been maneuvering to expand its institutional footprint, such as by introducing an emergency renminbi liquidity arrangement under the auspices of the Bank for International Settlements (BIS). Similarly, the basket of currencies underpinning the International Monetary Fund's special drawing rights (SDR, the IMF's reserve asset), now includes the renminbi, alongside the dollar, yen, euro, and pound sterling. And the BRICS (Brazil, Russia, India, China, and South Africa) have also discussed ways to push back against dollar hegemony, such as by issuing a joint reserve currency to bypass the dollar and other major Western currencies (as well as offering an alternative to SDR).

Finally, one of the most eagerly anticipated technological developments in this area is China's creation of digital payment alternatives. China's central bank introduced a digital currency, the e-CNY, in 2016 and offered this payment option to participants at the 2022 Olympics in Beijing. When fully implemented, the e-CNY will function independently of other payment and financial-messaging systems. By offering cheaper, faster, and safer transactions, a Chinese digital currency could make the renminbi more attractive and therefore more widely accessible and liquid. Promoting the e-CNY for trade and investment could accelerate renminbi internationalization.

But underlying trade and investment patterns must change before the global currency hierarchy does. Here, the China-centered Regional Comprehensive Economic Partnership, as well as China's Belt and Road Initiative, could help internationalize the renminbi by multiplying economic interactions and encouraging renminbi use in third-country trade and investment. Still, in the medium term, renminbi internationalization is likely to encounter substantial hurdles, owing to China's maintenance of capital controls and broader balance-of-payments constraints.

Why sanctions are an unlikely tipping point for dollar dominance

Following Russia's invasion of Ukraine, geopolitical blowback is widely seen as threatening dollar dominance. To fully grasp what today's turbulence means for the dollar system, we must however move beyond the motivations of countries targeted by sanctions. Many countries benefit from US currency coercion because they share the core principles behind US sanctions. Countries supporting sanctions on Russia have strong geopolitical incentives to continue holding and using dollars for international reserve and payment purposes. Supporting the dollar reinforces the constraining impact of the sanctions and helps ensure their future effectiveness. The economic incentives these governments previously had to diversify away from traditional currencies, particularly the U.S. dollar must now be weighed against their geopolitical incentives to hold dollars. Together, the coalition arrayed against Russia accounts for more than 90 percent of global currency reserves, approximately 80 percent of global investment, and 60 percent of world trade and world economic output. Overcoming that dominance would be difficult even if every country that has declined to sanction Russia fell in line behind an organized anti-dollar coalition. Moreover, countries not participating in sanctions against Russia do not necessarily disagree with the goals behind them: ending the war in Ukraine and deterring future territorial aggression. The coalition behind the sanctions against Russia is broad, wealthy, and militarily powerful, and its objective of ending Russia's barbarous war is widely shared, even by those not participating in the sanctions. Geopolitically induced dollar support is rather likely to stabilize dollar holdings.[10]

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[10] Carla Norrlöf, 'Will Economic Statecraft Threaten Western Currency Dominance? Sanctions, Geopolitics, and the Global Monetary Order', Atlantic Council, Atlantik-Brücke, September 2022 Colin Weiss, 'Geopolitics and the U.S. Dollar's Future as a Reserve Currency', International Finance Discussion Paper Federal Reserve, October 2022.

Having noted the relationship between sanctions and dollar dominance a decade ago, I am not suggesting there is no possible scenario in which sanctions threaten dollar hegemony, simply that the Russia sanctions are highly unlikely to represent such a tipping point.[11] Sanctions should be designed to prevent the unipolar currency order from further eroding. For example, by building broad sanctions coalitions in which participation is strictly voluntary and without forcing countries to choose sides. Sanctions can be costly for third parties. Whenever possible, steps should be taken to alleviate unintended consequences. In addition, sanctions should be reserved for clear-cut cases in which the international order is under threat, as in Ukraine, and should not be used for parochial purposes, as when sanctions were reinstated against Iran in 2018, even though Iran had not broken the terms of the nuclear deal, or when the Trump administration imposed overly harsh sanctions on Cuba. Imposing sanctions to pursue narrow U.S. interests raises legitimate fears among countries that they could be targeted next, motivating them to find alternatives to the dollar. Using sanctions to preserve the central elements of the liberal international order is a goal many countries can subscribe to, or at least tolerate, leaving the dollar as their continued currency of choice.

Other geo-political drivers …

Sanctions risk is not the only geopolitical factor shaping dollar use. In today's fraught international environment, countries question the wisdom of system-wide economic interdependence and privilege economic ties with friends. As security concerns eclipse economic concerns, the United States and Europe are limiting their economic dependence on foreign adversaries and pushing to relocate manufacturing and supply chains to allied nations in what has come to be known as "friend shoring." Just as countries are beginning to source goods and inputs from friendly nations, they may very well adopt the currencies of friendly nations. We should therefore expect a return to the Cold War logic in which economic relations more frequently align with security relations. With the United States at the bullseye of the largest security network in the world, the dollar stands to benefit from this shift. As during the Cold War, US security provision may induce allied dollar support.

Concluding remarks

In short, the size of the sanctioning coalition, the number of nonparticipating sanctions supporters, and the number of countries under the U.S. security umbrella, make large-scale currency diversification away from the dollar unlikely, at least in response to the Russia sanctions. To preserve the existing currency hierarchy and limit the long-term trend towards currency multipolarity, the US must adopt sound economic policies and use economic statecraft to promote the public good of international order from which most countries stand to benefit. The US cannot afford to alienate key allies, or a large portion of the international community, and simultaneously preserve the unipolar dollar era over the long term. For the first time since the collapse of the Bretton Woods gold standard, we are seeing a systemic limit on the dollar centered economic order and US foreign policy.

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[11] Carla Norrlof, 'Dollar Hegemony: A Power Analysis', *Review of International Political Economy* 21:5, 2014.

Opinion
Niall Ferguson

The Dollar's Demise May Come Gradually, But Not Suddenly

Rumors of the death of the US currency are as exaggerated as they are frequently repeated.

Founding fathers. *Photographer: Kirill Kudryavtsev/AFP/Getty Images*

By Niall Ferguson
April 23, 2023 at 12:00 AM EDT

"Every night," the president mused, "I ask myself why every country needs to trade in the dollar. ... Who decided it was the dollar after the disappearance of the gold standard? ... Today, countries have to chase after dollars to export, when they could be exporting in their own currencies."

The president in question was Luiz Inácio Lula da Silva of Brazil, and the venue was the New Development Bank in Shanghai on April 13. There was a great deal of interest in this latest news about Lula when I visited Sao Paulo last week. To me, however, the striking thing was how un-new it was. Lula's words immediately brought to my mind the musings of another president more than half a century ago:

> The convention whereby the dollar is given a transcendent value as an international currency no longer rests on its initial base. ... The fact that many states accept dollars ... in order to make up for the deficits of [the] American balance of payments, has enabled the United States to be indebted to foreign countries free of charge. Indeed, what they owe those countries, they pay ... in dollars that they themselves can issue as they wish. ... This unilateral facility attributed to America has helped spread the idea that the dollar is an impartial, international [means] of exchange, whereas it is a means of credit appropriated to one state.

The speaker then was President Charles de Gaulle of France, and the date was Feb. 4, 1965. It was de Gaulle's broadside against the dollar that prompted his finance minister, Valéry Giscard d'Estaing, to coin the memorable phrase "exorbitant privilege," which encapsulated the French complaint.

Being fed up with the dominance of the mighty dollar is, in other words, old hat. Indeed, it is such a recurrent theme of financial journalism that one can identify cycles in the use of the phrase "exorbitant privilege." Recent peaks, according to Google, were in 2007, 2011 and 2014. The Google "Ngram" for "de-dollarization" follows a similar path.

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Avoiding Stagflation Will Take Brave Central Banks

I first wrote an article on the subject nearly two decades ago, in June 2004. I was then an occasional contributor to *The New Republic* and my theme was the grave challenge to dollar dominance posed by the creation of a single European currency.

"For the United States," I wrote portentously, "the question is: How long can [the] dollar standard last? As long as the dollar is ascendant, the United States can continue to run huge trade deficits and budget deficits, without having to worry about serious economic fallout. But if the dollar were to lose its status as the world's reserve currency, and suffer a more precipitous slide, that could have grave consequences. Unfortunately for Americans, the sheer magnitude of the imbalances, along with the emergence of suitable alternative – the Euro – have made this a distinct possibility."

Fortunately for me, a man is not under oath when writing such stuff.

Readers will therefore understand why my initial response is one of skepticism to any new claims that the demise of the dollar is imminent. But here they come again – not just Lula but a cluster of widely respected economic commentators. According to Peter C. Earle of the American Institute for Economic Research, "the dollar's fate as the lingua franca of world commerce over the long haul may already be sealed."

For Earle, it is American overuse of financial sanctions that is to blame. The more the US exploits its power to shut adversaries' economies out of the dollar payments system, the more other countries want to reduce their exposure to that risk. Hence recent agreements between China and Brazil, China and France, and India and Malaysia, to settle trades in one another's currencies.

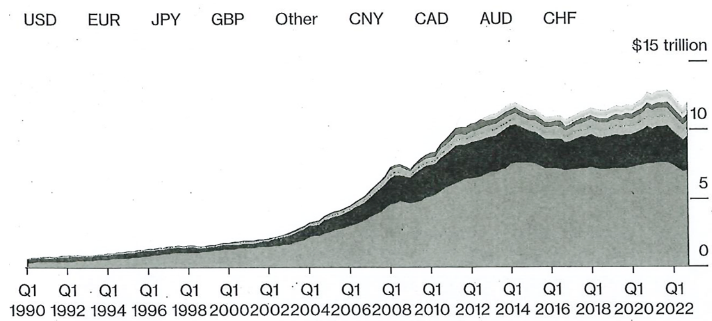
"Prepare for a multipolar currency world" was Gillian Tett's message in a recent *Financial Times* piece. Earlier this month, while Chinese president Xi Jinping was in Moscow, Russian President Vladimir Putin pledged to adopt the renminbi for "payments between Russia and countries of Asia, Africa and Latin America" to reduce Russian exposure to "toxic" dollar-denominated assets.

Because of such trends, according to Stephen Jen of Eurizon SLJ Capital, the dollar has already "suffered a stunning collapse." "The USD is losing its market share as a reserve currency at a much faster rate than is commonly believed," Jen wrote in a recent research note quoted at length by Robin Wrigglesworth in the FT. "The main driver of the collapse in USD's reserve status in 2022 may have reflected a panicked reaction to property rights being jeopardized" by the freezing of Russia's foreign currency reserves following its invasion of Ukraine. "What we witnessed in 2022 was sort of a 'defund-the-global-police' moment."

That's a nice line, but so was the eurotrashing of the dollar 19 years ago. So, let's take a closer look at the data. It's true that, conventionally measured, the dollar now accounts for a smaller share of international reserves than it did in 1999 – down from just above 70% then to 59%. However, as Brad Setser of the Council on Foreign Relations has pointed out, if you take the X-axis back to 1995, you can see that the dollar share of international reserves is higher today than it was back then.

The Dominant Dollar

Global foreign exchange reserves



Source: International Monetary Fund; Brad Setser

In any case, the principal shift that has occurred since the 1990s is that the euro has become the world's second-favorite reserve currency (which would have been a smarter but more boring and therefore less publishable thing for me to have predicted in 2004). The same goes for international debt issuance, international loans, foreign exchange turnover and global payments through Swift: In each domain (especially the last) the euro has clearly established itself as *numero dos*.

The fact that the euro area countries joined the US in imposing financial sanctions on Russia greatly weakens the argument that it is American overuse of sanctions that is undermining dollar dominance. As Setser notes, the invasion of Ukraine and subsequent sanctions don't seem to have had a discernible effect on reserve allocation, even when you take into account the various sovereign wealth funds, which also accumulate foreign currency assets. The Chinese have actually increased their holdings of so-called "agency" bonds issued by US government entities such as the Federal Housing Administration and the Government National Mortgage Association.

The clinching data point was provided last week by Brent Donnelly of Spectra Markets, who used Bank for International Settlements statistics to show that, when it comes to major currencies' shares of global transactions, the dollar's privilege is still exorbitant. Every three years since 1989, the BIS has put the dollar's share at between 80% and 90%. There has been no downward trend.

It is not hard to explain why the Chinese renminbi remains such a small share of international reserves: "capital controls" are the only two words you need to say to end the discussion. As Michael Nicoletos recently argued, without capital controls, a very large amount of Chinese capital would leave the country in search of diversification and more secure property rights. The Bank of England made this point in a seldom-cited but excellent paper a decade ago. The counterfactual of a convertible renminbi is one of a significantly depreciated currency.

Former Treasury Secretary Larry Summers had a good line about all this back in 2019. "You cannot replace something with nothing," he said. What other currency is preferable to the dollar as a reserve and trade currency "when Europe's a museum, Japan's a nursing home, China's a jail, and Bitcoin's an experiment"?

If you are structurally long the dollar (as I am) and like that sort of thing (as I do), I can also recommend reassuring takes from my Bloomberg Opinion colleagues Tyler Cowen and John Authers. Foreigners just love our green-colored pieces of cloth with their rugged founders' faces and their quaint masonic iconography, argues the former. "De-dollarization isn't happening at all," says the latter, because "the dollar is the cleanest dirty shirt."

It is a cliché to say that we live in an ever-changing world. But if something doesn't change for half a century – the dollar is the dominant currency and some foreign leaders resent that – why do economists and financial journalists keep predicting the demise of the dollar every six or seven years?

Of course, there are many things in history that stayed the same for 50 years and then suddenly changed. That is precisely what makes history hard to predict. It's why people love to quote the exchange from Hemingway's *The Sun Also Rises*:

> "How did you go bankrupt?" Bill asked.
>
> "Two ways," Mike said. "Gradually and then suddenly."

But there is no basis for thinking that reserve currencies lose their status in anything resembling these ways. The transition from sterling dominance to dollar dominance was all gradual, even if it was punctuated by occasional sterling crises. Those happened roughly once a decade from 1931 until, well, last year. And despite all the crises, sterling still accounts for about 5% of global reserves. This is a tortoise race.

So what we need to look for are signs that another such gradual change could be getting underway. Just as the creation of the euro in the 1990s paved the way for a new silver medalist in the reserve-currency race, so – if you look closely – there are meaningful signs that the Chinese currency is gathering enough momentum to be a meaningful contender for bronze in, say, 2043, passing the yen and the pound.

In an important new paper, the Berkeley economic historian Barry Eichengreen and co-authors have called it "the renminbi's unconventional route to reserve currency status." Their argument is that China does not need full financial liberalization, including an open capital account, to increase the international use of its currency.

First, the rapid growth of central bank swap lines engenders "confidence that RMB can be obtained from the Chinese central bank." Second, the proliferation of offshore renminbi markets "reassures central bank reserve managers and other investors that they can convert RMB into dollars at stable and predictable rates."

The scale of both these developments is startling. Since around 2009, the People's Bank of China, the country's central bank, has negotiated bilateral currency swap agreements totaling 3.7 trillion renminbi ($550 billion) with at least 39 central banks. Since 2010, when renminbi trading in Hong Kong was first authorized, offshore markets have sprung up in 24 other cities around the world. By July 2021, 1.25 trillion renminbi ($200 billion) was deposited in offshore accounts – an order of magnitude smaller than offshore dollar deposits, but not nothing.

At the same time, as another excellent new paper by Horn et al. shows, China has established itself as an international lender of last resort, launching "a new global system for cross-border rescue lending to countries in debt distress."

In recent years, more than $170 billion in liquidity support has been extended to more than 20 countries, including repeated rollovers of swaps coming due. Chinese state-owned banks and enterprises have given out an additional $70 billion in rescue loans for balance-of-payments support. All told, China's bailouts are equivalent to more than 20% of total International Monetary Fund lending over the past decade.

The authors sum their story up as "Bailouts on the Belt and Road," noting that recipients of funds tend to be Belt and Road Initiative borrowers and that the interest rates they pay are relatively high compared with Western loans to countries in similar circumstances.

The serious study of history is all about pattern recognition. Both sets of authors spot the same pattern. "The RMB today," write Eichengreen et al., "is not unlike the dollar in the 1950s and 1960s. Convertibility of RMB into dollars today is limited by capital account restrictions, while convertibility of dollars into gold was restricted by US monetary law under Bretton Woods. The 1950s and 1960s were the decades of the Bretton Woods System, when the dollar had to be backed by gold but was not convertible into the metal in the US. The offshore gold market in London then and the offshore RMB market today are products of a similar phenomenon, namely the imperfect convertibility of an international currency (the dollar then, the RMB now) into the ultimate reserve asset (gold then, the dollar now)."

Horn et al. also see "historical parallels to the era when the US started its rise as a global financial power, especially in the 1930s and after World War 2, when it used the US Ex-Im Bank, the US Exchange Stabilization Fund and the Fed to provide rescue funds to countries with large liabilities to US banks and exporters. Over time, these ad hoc activities by the US developed into a tested system of global crisis management, a path that China may possibly pursue as well."

It had not fully struck me until I read these papers that the US dollar rose to global dominance before financial liberalization, which happened in the 1980s and 1990s. And part of its rise took the form of acting as an international lender of last resort.

Another reason the dollar slowly displaced sterling was that American financial technology raced ahead of British. Something similar is also happening today: China has pioneered online payment platforms on a far larger scale than anything we have in the West. As my Stanford colleague Darrell Duffie points out, China's much-vaunted central bank digital currency (e-CNY) is not the thing to watch. It's still Alipay, which handles three orders of magnitude more transactions than e-CNY and already has a large international presence, including 2.2 million users in the US.

Meanwhile, the US government is running significantly higher deficits than the ones I wrote about in 2004. And, unlike two decades ago, the Federal Reserve has been monetizing a large part of the deficits. Back then, the Fed balance sheet was 6% of GDP. Now, after successive rounds of quantitative easing and other interventions, it is up to 35%. The 2021-23 surge of US inflation cannot be explained without reference to major errors of fiscal and monetary policy. If the US intends to preserve its global monetary dominance, it is concealing that intention very well.

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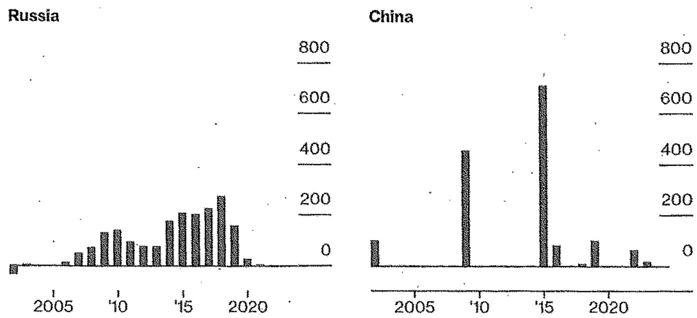
One striking consequence of these developments has been a significant surge in the dollar price of gold, which has risen more than 50% in the past five years, at a time when US Treasuries have fallen by 8%. John Maynard Keynes famously called the gold standard a "barbarous relic," but there is nothing barbarous about a non-interest-bearing asset that outperforms an interest-bearing one. Data from the World Gold Council are revealing on this score. According to the most recent figures, the euro area holds 30% of total world official gold holdings, the US 23%, whereas Russia and China together hold just 12%.

However, the top buyers of gold between 2002 and 2023 were Russia (1,876 metric tons) and China (1,525 tons), with Turkey, India and Kazakhstan some way behind. The top sellers over the same

period were the euro area (minus 1,726 tons) and Switzerland (minus 1,158 tons), with the English-speaking countries (minus 87 tons) far behind.

All That Glitters

Additions to gold reserves in metric tons



Source: World Gold Council

Yet this is not to suggest that gold is another, more ancient rival to the dollar. It is far from clear that accumulating gold will solve the Russian – and Chinese – problem of vulnerability to US sanctions. It is just a good illustration of how slowly the global monetary system changes.

The year before de Gaulle's diatribe against the dollar was when my favorite James Bond film was released. *Goldfinger* remains a wonderful cinematic achievement, from the villain's first victim – the actress Shirley Eaton, clad only in gold paint – to the exquisite exchange between Bond and Gert Frobe as a laser beam inches towards Sean Connery's groin:

> 007: Do you expect me to talk?
>
> Goldfinger: No, Mr. Bond. I expect you to die!

But, aside from the almost unmitigated sexism, one aspect of *Goldfinger* has dated absurdly. It's the moment when the man from the Bank of England explains why Goldfinger's suspicious accumulation of gold is a problem requiring 007's attention:

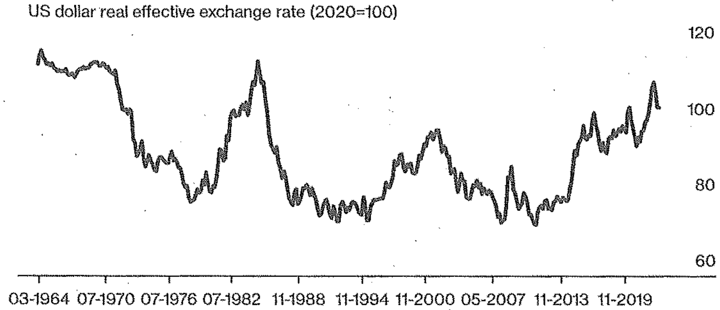
> We here at the Bank of England are the official depository for gold bullion. Just as Fort Knox, Kentucky, is for the United States. We know the amounts we each hold and the amounts deposited

in other banks. We can estimate what is being held for industrial purposes. Thus, both governments can establish the true value of the dollar and the pound.

Those days were over within seven years, when President Richard Nixon broke the link between gold and the dollar that had been the anchor of the Bretton Woods System. Since then, the currencies of the world have fluctuated against one another and against gold, sometimes quite violently, sometimes barely noticeably.

Hardly a Currency Crisis

US dollar real effective exchange rate (2020=100)



Source: Bank for International Settlements

Just look at the trade-weighted real effective exchange rate of the dollar since the "Nixon shock." There's a 32% plunge from July 1971 to October 1978. Then there's a 49% rally to March 1985. Another 36% plunge to August 1992. Then up 33% to February 2002. Back down 26% to July 2011. And all the way up 53% to October 2022.

You can say what you like about the dollar, but it sure is bouncy. And it is precisely this lack of rigidity that explains the persistence of the post-1971 monetary system. Unlike the gold standard, the dollar system has an elastic anchor – a fiat dollar, the supply of which is primarily determined by domestic economic considerations.

Other currencies are very welcome to compete: the euro, the renminbi – and (who knows?) maybe the future "BRICS currency" imagined by Lula in Shanghai. But do not expect "de-dollarization" to follow the Hemingway two-stage model. The world changes its monetary anchor only one way. Gradually.

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To contact the author of this story:
Niall Ferguson at nferguson23@bloomberg.net

To contact the editor responsible for this story:
Tobin Harshaw at tharshaw@bloomberg.net

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Written Testimony for House Committee on Financial Services, Subcommittee on National Security, Illicit Finance, and International Financial Institutions

Submitted by Jeff Ferry, Chief Economist, Coalition for a Prosperous America

Submitted for the Hearing Entitled: "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency" held on June 7, 2023

CPA Testimony, "Dollar Dominance, Today and in the Future" submitted June 12, 2023

Dear Members of the Committee:

I am Chief Economist at the Coalition for a Prosperous America, a bipartisan coalition of U.S. manufacturers and agricultural producers focused on rebuilding U.S. prosperity. My comments today rely on my experience in international financial economics: as a young economic journalist based in London in the early 1980s, I traveled often to Brussels to write about the creation of the 8-nation Exchange Rate Mechanism, the precursor to the Euro. Later, I held offshore bank accounts in multiple currencies, to manage consulting fees I received from clients in the U.S., U.K., and elsewhere. For the last six years, at the Coalition for a Prosperous America, I have written about U.S. dollar policies and how they impact the U.S. economy.

CPA agrees with the goals of the Committee regarding the national security and economic benefits arising from wide use of the dollar. As many of the hearing witnesses recognized, dollar dominance has a downside of persistent overvaluation making America's goods producers less price competitive in global and domestic markets which reduces growth and quality employment. We believe that Congress should start considering policies to manage the dollar exchange rate to grow America's economic size, strength and global reach while also continuing the wide global use of the dollar as a stable, safe and liquid currency.

Dollar dominance is a valuable tool or asset for the United States government on the world stage. It allows us to wield U.S. power through sanctions or other measures. Such sanctions have had powerful impacts on Russia, Iran, and other enemies of democracy.

Dollar dominance does not exist in a vacuum. It relies on the size, scale, and power of the U.S. economy, the power and reach of our banking system, the scale of our investment community, and the world-leading products and technologies invented, developed, and produced in the U.S. The choice by international investors, governments, central banks, and private corporations to hold the overwhelming majority of their liquid assets in dollars is the result of all these positive attributes of the United States. Consumers and governments wish to buy American products, our financial assets are seen to be strong, reliable, and highly liquid, and the world has faith in the

credit of the United States. In other words, they trust us to be less likely to succumb to uncontrollable inflation than almost any other government in the world.

Commentators often say that the U.S. dollar replaced the pound sterling as the world's preferred reserve currency either after World War I or after World War II. Some might say this transition took place between 1919 and 1956.

This is an oversimplification. The two important uses for a currency, both domestically and internationally, are as a means of payment and a store of value, in other words an investment. In the international arena, what this means is that an international currency is used to pay for and finance international trade and it is also a preferred choice for international investments.

Over the first half of the 20th century, the dollar replaced sterling **and gold** as the leading currency for both trade and investment. Before 1914, national governments often settled international debts with payments in gold. Individuals, companies, and banks outside the British Empire typically held their safe investments in gold, not sterling. In those days a rich businessperson in a country prone to revolution might make international payments in sterling, but they would keep gold bars at a bank or in their basement as their preferred store of value.

After 1919, modern technology tended to make gold obsolete as both payment and store of value. This has given the dollar a powerful international role that no currency has ever enjoyed in the history of the world. You might say that American Express opened its first international office in Paris in 1895, and since then the dollar has never looked back.

Dollar dominance is based as much on international investors' preference for dollar assets as it is on governments' preferences. The term "reserve currency" is therefore a bit misleading. The IMF tracks global official foreign currency reserves held by governments and reported a total of $11.96 billion in reserves at the end of 2022. The U.S. dollar accounted for 58.4% of that total, down four tenths of a percentage point from a year earlier. But the euro also fell slightly, to 20.5%, and the Chinese renminbi also fell slightly, to a minimal 2.7%.

But official government reserves are dwarfed by the private sector's international financial holdings. According to the Economist Magazine, private sector cross-border financial holdings reached $130 trillion in 2020, roughly ten times the size of official reserve holdings. Private sector cross-border holdings of financial assets continue to rise, propelled by the rise in global savings available for investment and the increasing popularity of international investing. To give you two practical examples, consider the assets of two of the world's great savings nations: Singapore and Norway. The Singaporean central bank holds just under $500 billion in foreign exchange reserves. But its two sovereign wealth funds hold twice as much, a combined total of $1.19 trillion in assets. The central bank's reserves are held to ensure that Singapore can afford to buy imports, even in the case of global disruptions. The sovereign wealth funds are charged with investing the last forty years of accumulated surplus so as to generate returns for the next

100 years of Singaporean citizens. All those funds favor dollar investments, but the sovereign wealth funds trade more actively, and they favor equities (stocks) over bonds or cash. It's the same for Norway. Norway's central bank holds $768 billion in assets while its sovereign wealth fund holds $1.2 trillion in assets. This means that private sector funds exercise more influence over the value of the dollar than do official reserves.

On top of these sovereign wealth funds there are hundreds of privately owned and managed hedge funds and mutual funds that invest trillions of dollars internationally. Like sovereign wealth funds, these funds tend to invest as much in equities as in bonds. The primary drivers of investing in U.S. government bonds are U.S. interest rates and faith that the federal government can avoid protracted bouts of inflation. The primary drivers of investment in U.S. equities are faith in the future ability of these corporations, led by Apple, Microsoft, Nvidia, Tesla, and Berkshire Hathaway, to continue generating profits.

As an example, consider this quote from three executives at the Bank of Israel, referring to the central bank:

> In seven years, the BOI moved from a classic reserves portfolio to a multi-asset diversified portfolio that includes a sizeable allocation of equities and corporate bonds. These riskier assets significantly increased the returns on reserves in recent years.[1]

So ultimately, continued dollar dominance depends on two things: the continued strength, robustness, reliability, and growth of the U.S. economy, especially its businesses, and the continued liquidity of global dollar financial markets.

Regarding the foreign exchange value of the dollar, the dollar is overvalued by 12% according to the June 1st edition of our CPA Currency Misalignment Monitor, published in partnership with the Blue Collar Dollar Institute. We are far more overvalued against certain trading partners. We are overvalued by 22% against the Chinese renminbi, by 31% against the Japanese yen, and by 41% against the Taiwanese dollar. The term "trading partner" is a misnomer. "Trading rival" might be a better term. China is of course a political and economic rival. Taiwan is a political ally but an economic rival, for example in the production of semiconductors.

In all these cases, the overvaluation of our dollar undermines the competitiveness of U.S. industry and U.S. agriculture. It enlarges our trade deficit, weakens our economic growth and

[1] Golan Benita, Nadine Baudot-Trajtenberg and Amit Friedman, *The challenges of managing large FX reserves: the case of Israel,* BIS Paper No. 104, Oct. 2019.

exacerbates inequality. It makes it harder for U.S. companies to compete and survive in our global economy.

Today, U.S. economic power rests on the fact that we account for 23.3% of global gross domestic product, per World Bank figures for 2021. China accounts for 17.7%, while the Eurozone accounts for 14.6%. In recent years, the Eurozone has tended to grow more slowly than the U.S. economy. But the Chinese economy has grown more rapidly.

In the 1870s, the U.S. surpassed Great Britain as the world's largest economy. By the 1890s, this was clear to virtually all international observers, and the U.S. dollar began to displace the pound sterling as the world's dominant currency.

Today the U.S. economy is substantially larger than the Chinese economy. Although China has grown faster in recent years, its debt-fueled growth is now faltering. Its global exports are larger than ours today. Continued U.S. economic strength, global power, dollar dominance, and the fight for democracy rest most of all on the size, scale, and power of the U.S. economy. The best way to accelerate that size and strength is through a fairly valued dollar that makes U.S. industry competitive.

A fairly valued dollar that reduces or eliminates persistent trade imbalances would be in the best interests of the U.S., and even of many foreign governments. A fairly valued dollar would increase the strength of our domestic economy, with benefits for wages, employment and profits. Companies like Apple and Tesla and Berkshire Hathaway would grow stronger with a competitive dollar. That would make U.S. assets more attractive globally. We believe the federal government should take action to ensure the dollar moves to a fairly valued level and maintain it at that level. The action required is actually not much more than telling the market its preference, backed up with occasional modest market interventions, well within the scope of existing Treasury funds.

We favor a fairly valued, *competitive*, dollar AND a widely used, *dominant* dollar. We believe that a competitive dollar would increase the broad use of the dollar. Why? Because a federal government committed to maintain a fairly valued dollar would reduce the volatility of the dollar. That would encourage wider use of the dollar.

Recent comments by Brazilian president Lula illustrate the point. On a recent visit to Shanghai, Lula said he would like to pay for imports in his own currency or other currencies instead of the dominant dollar. Last year, Brazil spent $49 billion, 18% of its total import bill, on fuel. For Brazil and many oil importers, the oil and gas price hikes due to the Russia-Ukraine war were painful. They were exacerbated by the 14% rise in the foreign exchange value of the dollar last year. That hit Brazil hard. Brazil is one of many emerging market nations that are not strongly aligned in the U.S.-China confrontation. For all those nations, a more stable, less volatile dollar, one that did not jump every time the Wall Street rumor mill suggested the Fed was considering

an interest rate increase, would make them more content to continue to use the dollar for their international trade needs.

We believe the U.S. could and should manage the dollar exchange rate, but with a light touch. Many other nations do this quite successfully. Once the capital markets understand that a government intends to maintain its currency at a competitive level, it conforms to the market leadership set out by that government. It would take only rare and not very large interventions to guide the dollar towards its equilibrium value.

Members of the public often confuse the notion of a "strong" dollar with a widely used dollar, which I am here calling a "dominant" dollar. Market participants such as Ray Dalio talk about the shifting international balance of power, but what they are really doing is giving investment advice as to whether or not the dollar, euro, or another currency is a good investment at a particular moment in time. A widely used, "dominant," dollar is more important for U.S. international economic power than any particular value of the dollar.

I want to point out that a fairly valued, competitive dollar would also be good for domestic anti-inflationary policy. Managing the dollar to hold it at a fair value would free the Federal Reserve to fight inflation without concern that raising interest rates would lead to an over-strong dollar and inflict more damage on industry and agriculture.

Can we have the best of all worlds on the dollar? I believe we can. We should continue to encourage broad and deep use of the dollar for trade, lending, and investment. We should also manage the dollar to a competitive level. We should also be selective in our use of sanctions and not implement them excessively, as other witnesses before this committee have explained. If we do all these things, we will support the continued use of the dollar as the dominant global currency while also supporting U.S. economic growth, which is the fundamental platform on which U.S. economic power and the attractiveness of the dollar rest.

Thank you.

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SECTOR IN-DEPTH
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Contacts

Gabriel Agostini +1.646.947.9933
AVP-Analyst
gabriel.agostini@moodys.com

Madhavi Bokil +1.212.553.0062
Senior Vice President – Strategy and Research
madhavi.bokil@moodys.com

Vincent Gusdorf, CFA +33.1.5330.1056
SVP-DeFi & Digital Assets Analysis
vincent.gusdorf@moodys.com

Elena H Duggar +1.212.553.1911
Managing Director-Credit Strategy
elena.duggar@moodys.com

Atsi Sheth +1.212.553.7825
MD-Global Head of Credit Strategy & Research
atsi.sheth@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
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Macroeconomics – Global

Dollar dominance will persist for decades despite new challenges

Summary

A steady decline in the US (Aaa stable) dollar's share of central bank reserves, simmering geopolitical tensions and growing brinkmanship in US politics have increased speculation that the US dollar's global dominance is nearing its end. We expect a more multipolar currency system to emerge over the next few decades, but it will be led by the greenback because its challengers will struggle to replicate its scale, safety and convertibility in full. Our view could change, however, if confidence in US institutions wanes, economic sanctions multiply, protectionism rises, and breakthroughs in central bank digital currencies (CBDCs) outside the dollar improve their effectiveness over time.

» **US dollar continues to dominate international trade and finance**. Small, but growing allocations to the renminbi, as well as the Australian and Canadian dollars, have reduced the US dollar's share of central bank holdings to 58%, from 71% in 2000. However, the dollar's liquidity, stability and lower transaction costs mean it retains dominant shares of trade invoicing, cross-border debt securities and loans.

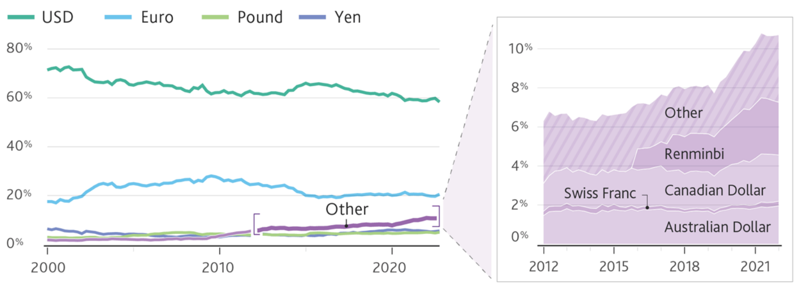
» **Alternatives are not viable**. The British pound's decline illustrates how dominance can fade over time. We expect further reserve diversification as markets deepen, but the US dollar's current rivals, the euro and renminbi, will struggle to rapidly emulate three core traits: (1) the US economy and financial system are large and open enough to absorb the world's excess savings; (2) the US Treasury market is deep, liquid and safe; and (3) the US dollar is fully and reliably convertible into other currencies. The euro could regain some ground, but the lack of a common fiscal policy and the lingering risks of financial instability will limit its ascent. China's (A1 stable) capital controls and development model will curtail renminbi's rise.

» **Domestic, foreign and technological trends could erode dollar strength over time**. The greatest near-term danger to the dollar's position stems from the risk of confidence-sapping policy mistakes by the US authorities themselves, like a US default on its debt for example. Barriers to trade and foreign investment enacted to protect sectors disadvantaged by a strong dollar, like manufacturing, would also undermine a core principle of open and unfettered access. Sanctions further inhibiting the free flow of the dollar in global trade and finance could encourage greater diversification. Lastly, a broader technological shift towards CBDCs could offer an equally cost-effective and safe means of making international payments.

US dollar continues to dominate international trade and finance

A multi-decade decline in the US dollar's share of central bank holdings of official reserves is often cited as evidence of its eroding dominance. At the end of last year, US dollars represented about 58% of official foreign exchange (FX) reserves, down from 71% at the turn of the century. A recent IMF study showed that a quarter of the decline in 2021 can be explained by a shift into the Chinese renminbi, which accounts for 3% of global reserves (a third of which are held by Russia). Moves into other, less-traded reserve currencies like the Australian and Canadian dollars were responsible for the remainder (see Exhibit 1).[1]

Exhibit 1
Diversification into less-traded reserve currencies has reduced the US dollar's share of global official reserves
Currency composition of global foreign exchange reserves, % of total



China began reporting reserves between 2015 and 2018.
Sources: IMF and Moody's Investors Service

However, this long-standing trend is more of an evolution in active reserve management in an era of ultra-low interest rates than a revolution against the greenback. It also reflects falling transaction costs and deeper markets for traditionally illiquid currencies given improvements in market-making technology.[2] Although the dollar's share in central bank portfolios fell slightly more rapidly in 2022, these kinds of moves are not uncommon and were driven by EM central bank efforts to defend currencies and valuation effects on reserves from the rapid rise in US interest rates.[3]

We expect a further deepening in developed market currencies and active deployment of excess central bank reserves will continue to eat into the dollar's share of global reserves.[4] Nonetheless, these efforts will be very slow and ultimately limited by the unmatched scale and safety of the US dollar, which incentivizes central banks to hold it in reserve for liquidity needs and downside protection (see next section).

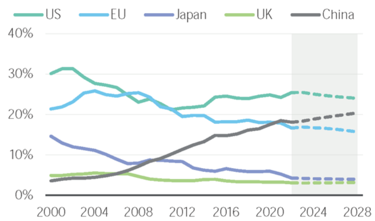
By contrast, the liquidity, stability and lower transaction costs associated with the US dollar have meant that the share of international trade invoiced and settled in dollars has remained large and stable over the last 20 years, despite the US absorbing a smaller share of global exports; this also suggests that most international trade will continue to be invoiced in US dollars even as the US economy's share of global economic output and trade declines (see Exhibits 2 and 3). The most comprehensive data available indicates that roughly 40% of global exports are invoiced in dollars,[5] which is about four times the share of global exports destined for the US. While the euro's share of export invoicing is also significant at 46%, direct trade in and around the euro area masks its comparatively narrower global reach and smaller role in central bank reserves.[6]

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.

Exhibit 2

The US' share of global GDP is gradually diminishing...

Select reserve currency country GDP as a share of global GDP, %



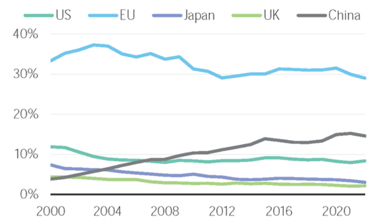
Note: IMF projections for 2023-28.

Sources: IMF and Moody's Investors Service

Exhibit 3

...along with its share of global exports

Select reserve currency country exports as a share of global exports, %



Sources: IMF and Moody's Investors Service

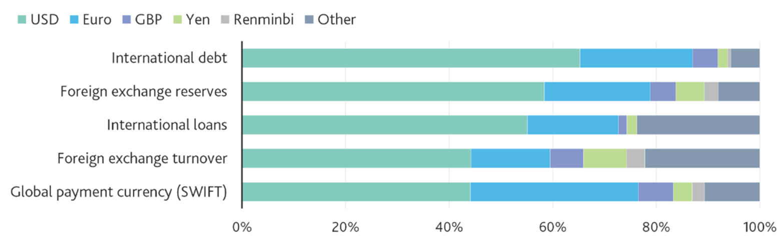
In part because of its dominant role as a medium of exchange, the US dollar also continues to account for a large share of global banking activity, debt securities and investment. About 60% of international banking liabilities (primarily deposits) were denominated in dollars in 2020 and have been relatively stable at this level for the last 20 years.[7] As of Q4 2021, the US dollar accounted for 55% and 65% of outstanding amounts in international loan and debt markets.[8] The latter was up from 48% in 2008. The dollar's share of cross-border payments intermediated through SWIFT (a financial messaging system used to facilitate global financial transactions) has also grown to 43% as of April 2023, up from 36% a decade prior. Over the same period, the euro fell to 32% from 38%. The renminbi's share only rose from 0.7% to 2.3%.

Indeed, across many measures of the global trade and financial system, the dollar remains broad-based and unmatched (see Exhibit 4).

Exhibit 4

US dollar dominance remains broad-based and unmatched in the global trade and financial system

Share of international financial activity by type and currency, %



Note: the latest data for foreign exchange reserves and turnover are for Q4-2022 and April 2022, respectively. SWIFT data as of April 2023. International debt and loans data as of Q4-2021. International loans are those made by banks outside the currency area to borrowers outside the currency area. International debt corresponds to the European Central Bank's "narrow" measure of international debt securities – defined as securities sold outside the issuing country, excluding debt in the issuer's own currency.

Sources: ECB, IMF, BIS, SWIFT and Moody's Investors Service

Alternatives are not (presently) viable

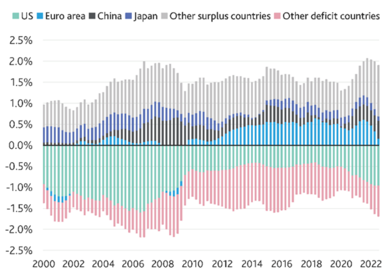
The postwar fall of the British pound demonstrates that the dominance of a global reserve currency is not guaranteed (see box below). However, there are three core characteristics underpinning the US dollar's current dominant position, that its closest competitors – the euro and the renminbi – will find difficult to replicate:

» **The US economy and financial system are large and open enough to absorb the world's excess savings.** The US economy will remain one of the world's largest and most diversified economies for the foreseeable future. It also boasts a large and open financial system that allows for unfettered foreign investment in and out of US assets. Collectively, these traits allow the US to absorb the rest of the world's excess savings and capital flows, as well as the trade deficits they entail. Last year, the US' current account deficit averaged about 1% of global GDP, an amount equivalent to about half of the excess savings generated by trade surplus countries (see Exhibit 5).

» **The US Treasury market is deep, liquid and safe.** Most countries hold their reserves in a currency with deep and liquid markets to ensure they can access them whenever needed. At $27 trillion, the US Treasury market is by far the world's largest sovereign bond market and foremost safe asset – as reflected by the Treasury's use as the world's benchmark risk-free asset – with its closest competitors too small or fragmented to accommodate the rest of the world's reserve needs (see Exhibit 6).

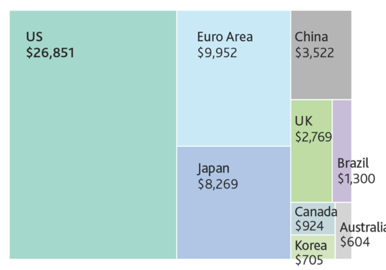
» **The US dollar is fully and reliably convertible**. Markets have full trust and confidence in the strength and governance of the US financial system and that the government will respect investor property rights.

Exhibit 5
The US absorbs a significant share of the world's external surpluses
Current account balance, % of global GDP



Note: Four-quarter moving average.
Sources: IMF and Moody's Investors Service

Exhibit 6
The US Treasury market is the deepest by far
Size of major government bond markets, $ billions



Note: Central government debt securities.
Sources: World Bank and Moody's Investors Service

Moreover, the Federal Reserve's expansion of its dollar swap lines with major central banks during the global financial crisis effectively guaranteed dollar-denominated deposits held abroad, and reinforced its role as the international lender-of-last-resort. It also strengthened its international reach when it introduced a Treasury repo facility for central banks and gave institutions not covered by swap lines the opportunity to liquify (rather than liquidate) their US Treasury holdings.[9] Together, these dollar-based liquidity facilities stabilize global financial market conditions during periods of stress and give market participants confidence to hold dollar-denominated assets.[10]

Euro could regain lost ground, but risk of further financial instability and fragmentation will limit its ascent

The world's second largest reserve currency, the euro, shares some of these characteristics with the US dollar, which could allow it to regain some of its share of reserve portfolios lost after the euro area debt crisis. Its economy is large and boasts strong institutional arrangements, which have helped it match the dollar's dominance in global payments through the SWIFT network. The euro also

accounts for 46% of trade invoicing, suggesting that it is also an important currency in trade transactions, though much of that number includes trade in and around the euro area, which makes it more of a regionally dominant currency than a globally dominant one.

However, the risk of financial instability is a key hurdle for the euro's rise, and will remain so for as long as memories of the euro area's debt crisis linger and institutional arrangements to prevent its repeat remain incomplete. We have seen moves to create a banking union and to backstop euro area members through the European Stability Mechanism (Aaa stable), but overall progress has been slow and politically challenging.

Moreover, European securities markets suffer from the lack of a common fiscal policy and jointly-issued sovereign Eurobonds, with some euro member bonds trading at discounts to others. Though meaningful steps were taken to inch closer to a fiscal union during the pandemic, most notably through commonly-issued debt under the Next Generation EU recovery fund, more fiscal harmonization will be required before euro area member bonds are perceived as a single safe asset. In the meantime, the German Bund market is the nearest equivalent, but at $1.6 trillion it is just a fraction of the US treasury market ($27 trillion), and too small to meet the world's demand for risk-free assets.

China's capital controls and development model will curtail renminbi's rise

China's GDP could match that of the US sometime in the next decade, but the renminbi's path to global dominance will likely be hamstrung by strict controls on the flow of money into and out of the Chinese economy, which will likely remain a cornerstone of its development model. China's exports account for roughly 20% of GDP, nearly twice the US' share, and support large, consistent trade surpluses. As such, its trade-reliant economy is comparatively dependent on a competitive exchange rate and currency stability, both of which are secured, in part, by the country's tight capital controls. Indeed, the country's sensitivity to its exchange rate was displayed most vividly in 2015, when, following years of appreciation against the US dollar, the government devalued the yuan by nearly 3% against the dollar and imposed a series of higher rates, tighter capital controls and foreign-currency sales to prevent capital flight.

More generally, for the renminbi to be a dominant reserve currency, China would not only need to open its capital markets and develop institutions to back them, but also be willing to sacrifice the trade surpluses that capital controls have helped to foster. Given the major change that this would entail for China's growth model, progress in this direction over the next decade is likely to be limited.

Instead, we view a move to a more multipolar world dominated by the dollar, but with greater roles for its biggest competitors, as the most likely outcome – and one that has been more often the rule than the exception over the last 200 years.[11] China's recent moves to promote trade invoicing in yuan, as well as more speculative calls for a common BRICs currency, indicate that there is a strong desire for a greater role for more currencies in the global financial architecture, even if its realization is many years away. They also hint that a more multipolar world could slowly evolve as fault lines grow amid rising US-China tensions. Nonetheless, it is highly unlikely that any of these multipolar blocs will be able to replicate the US dollar's abovementioned constellation of unique traits or be willing to bear the trade-related costs that they entail. As such, we expect the low transaction costs and stable inflation that the dollar's dominance has fostered for the global economy to persist for the foreseeable future.

Box 1: The pound fall followed major economic shocks and the US economy's rise to global dominance

Before World War I (WWI), pound sterling was the world's reserve currency. However, shocks from two world wars and the Great Depression combined with long-term structural economic changes to end British hegemony and usher in the postwar dominance of the US dollar.

WWI marked the beginning of the end of the pound's global dominance. The war's paralysis of global trade severely harmed the British economy and magnified existing challenges for its traditional industries. War-induced depreciation of British foreign assets and disruption of global money markets further hampered its finance-dependent economy, which suffered declines in foreign earnings from financial services and dividends from abroad. A growing trade deficit and falling foreign income pressured the central bank's gold reserves and subjected the pound to speculative attacks, ultimately forcing Britain to abandon the gold standard in 1914.

The pound's global position grew increasingly precarious in the interwar period that followed, which included a failed attempt to reestablish the sterling's peg to gold and the Great Depression, the combination of which led to a breakdown in the international trade system that the pound once dominated. WWII only magnified its woes, destroying a quarter of Britain's national wealth, tripling its debt and draining its gold stock for arms purchases.

By contrast, the US' economic position was unmatched. By war's end, the US boasted half the world's manufacturing capacity, a third of its exports, two-thirds of its gold reserves and was the only major power with infrastructure largely unharmed. Although US institutions were too underdeveloped to assume the role of global reserve currency in the 1890s, when the US economy first surpassed Britain, they had been nurtured significantly afterwards, including through the establishment of the Federal Reserve in 1913. The US' hegemonic position was reflected in the 1944 Bretton Woods Agreement that established an international monetary system based on fixing countries' currencies to the US dollar, which in turn was convertible into gold – an arrangement that would cement the pound's fall and the dollar's hegemony.

A confluence of domestic, foreign and technological trends could erode dollar strength over time

Inside the US, weakening institutions and a political pivot to protectionism threaten the dollar's global role

The greatest near-term danger to the dollar's leadership stems from the risk of confidence-sapping policy mistakes by the US authorities themselves. Although we expect that politicians will eventually agree to raise or suspend the debt limit and avoid a default on government debt, greater polarization in the domestic political environment over the last decade has weakened both the predictability and effectiveness of US policymaking.

A default on US government debt, even if it were rapidly cured, would permanently weaken the US treasury's reputation as a global risk-free asset. In the near term, we would expect financial markets to rapidly reprice the risk of their US treasury holdings and trim their exposure commensurately, a process that is likely to induce uncertainty and financial volatility. Over the long term, efforts already in place to move away from the dollar would likely accelerate as increased volatility and diminished investor confidence reduce the benefit of holding and transacting in US dollars, slowly rendering the virtuous cycle of network effects that support its use into a vicious one that does the opposite.

The dollar's global reserve status and the strong foreign demand for dollar-denominated assets it generates has benefited the US economy by boosting equity values and lowering consumer borrowing costs, enabling higher consumption. The benefits have been significant for the sovereign in particular, as unwavering global demand for its debt supports its ability to carry a large and rising debt burden at relatively affordable rates.

However, these advantages come at the cost of a structurally stronger exchange rate and persistent trade deficits, which have disadvantaged the US' manufacturing sector and partly driven a political shift towards protectionism.[10] While barriers to trade remain limited and capital controls nonexistent, the domestic political climate has shifted since 2016 and these issues are more firmly on the political agenda. Were significant barriers to trade and foreign investment in the US to be enacted, a key pillar of the dollar's strength as a global reserve currency – open and unfettered access to US financial markets – would be undermined, likely shifting global capital flows to other developed market reserve currencies.

Outside the US, growing external imbalances and sanctions overreach could accelerate moves towards a multipolar world

The dollar's global status also comes at the expense of a higher external debt burden, which could ultimately trigger a crisis of confidence in the US dollar itself and accelerate the move to a multipolar world.

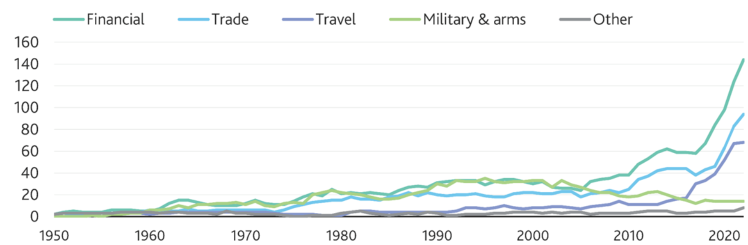
The US has been the primary provider of safe assets since WWII, absorbing the world's excess savings and acting as its insurer during global economic crises.[13] However, as the global economy and its demand for safe assets grow larger relative to the size of the US, its ability to be the sole provider could prove unsustainable. Indeed, large and persistent current account deficits, which reflect the US' absorption of the rest of the world's savings, have grown in lockstep with the US' deteriorating external position over the last 30 years, with US net foreign liabilities reaching 63% of GDP last year, up from 5% of GDP in the early 1990s.[14]

Left unchecked, the US' increasingly stretched external position could expose the dollar to a crisis of confidence if panicked investors head for the door. The US was last able to weather such a confidence shock in 1971, when central banks in Europe and Japan (Aaa stable) redeemed their dollar reserves for gold to prevent their currencies from appreciating. Though that run on the dollar triggered a devaluation and ultimately broke its peg to gold, the dollar's global primacy prevailed thanks to a lack of viable alternatives at the time. However, investors today would have a set of more readily available – albeit imperfect – reserve currencies to turn too if another run on the dollar transpired, an event that could rapidly downsize the US dollar's role in a multipolar world.[15]

In the meantime, sanctions overreach could incentivize targeted countries to reduce their USD exposure and seek alternatives. Competitor countries and currencies looking to extend their influence are likely candidates to fill the void, which could in turn support the growth of fragmented currency blocs outside the dollar-based ecosystem over the long term. As a recent example, the renminbi's share in Russian import settlements jumped to 23% last year, up from 4% in 2021, driven in large part by US sanctions limiting Russia's ability to export its commodities elsewhere.[16]

While much attention has been paid to the unprecedented scope and magnitude of Western sanctions levied against Russia, the US has rapidly escalated its use of them since the mid-2000s, and especially since 2017, most of which target the ability of institutions and individuals to use the dollar freely in global trade and finance (see Exhibit 7). According to the Global Sanctions Database, only 19 countries (about 13% of the world's countries) were subject to US financial or trade sanctions in the early 1960s; as of last year, that number had risen to 74 (38%).[17]

Exhibit 7
The US' reliance on financial, trade and travel sanctions has risen sharply
Number of US sanctions cases by type, 1950 - 2022



Note: A single case can contain multiple types of sanctions.
Sources: Global Sanctions Database and Moody's Investors Service

Technological change could weaken the dollar's global role or cement it further

The potential for interoperable, non-dollar CBDCs[18] to provide faster, cheaper[19] and more transparent ways to settle trade and financial transactions globally could reduce the dollar's usefulness as an intermediary. If they do, the positive network effects that arise from the

dollar's ubiquity could diminish as transition costs from the dollar to a CBDC fall. Central banks would also have fewer incentives to hold it in reserves if the dollar is used less often in trade invoicing. CBDCs could also allow customers to circumvent payment systems like SWIFT and CHIPS, which are dominated by the euro and dollar, and therefore subject to US and European sanctions.

Here, China is ahead of the pack. The e-CNY, its CBDC, will likely be the first issued by a major economy and is already available in several regions, including Hong Kong (Aa3 stable). Although primarily aimed at domestic use, the e-CNY is technically ready for cross-border transactions. Moreover, the e-CNY will be programmable, giving China control over its use outside its borders. Concerns about privacy, convertibility, regulation, and financial markets' maturity may hinder its international adoption, but even if the e-CNY is not widely used, it will likely act as a blueprint for CBDCs design elsewhere.

In the meantime, the Fed has also experimented with US dollar CBDCs,[20] which could further consolidate the greenback's dominance if its digital version were ultimately able to operate and transact with the many central bank and international accounts held within the Fed system.[21] The Fed's extensive central bank partner network lends itself to a wholesale CBDC in particular, as it would be limited for use by financial institutions and raise less privacy concerns than its retail counterpart.[22] Furthermore, wholesale payments account for 80% of total cross-border payments[23] and are well-known for their costliness and inefficiency, which makes them a likely candidate for the Fed and other central banks looking to upgrade payments systems. Overall, a digital dollar would be highly credible and very liquid, making it more attractive than many other CBDCs. Nevertheless, turning these experiments into reality will require solving major technical, legal, and governance challenges and, therefore, remains years away.

Endnotes

1 See Arslanalp, S., Eichengreen, B., and Simpson-Bell, C. 2022. "**The Stealth Erosion of Dollar Dominance: Active Diversifiers and the Rise of Nontraditional Reserve Currencies**." IMF WP/22/58.

2 "**The Stealth Erosion of Dollar Dominance: Active Diversifiers and the Rise of Nontraditional Reserve Currencies**." IMF WP/22/58. More specifically, the advent of electronic trading platforms, automated market making (AMM) and automated liquidity management (ALM) have deepened the markets for these currencies and lowered transaction costs, enabling greater investment from currency reserve managers.

3 See Eichengreen, Barry. "**Is de-dollarisation happening?**" *CEPR*. 12 May 2023.

4 See Arslanalp, S., Eichengreen, B., and Simpson-Bell, C. 2022. "**The Stealth Erosion of Dollar Dominance: Active Diversifiers and the Rise of Nontraditional Reserve Currencies**." IMF WP/22/58. The authors find that EM reserves held in excess of what was considered "adequate" by IMF standards totaled nearly $1.5 trillion in 2020. Excess reserves accounted for about 30% of total for the typical EM.

5 See Boz, Emine, et al. "**Patterns of Invoicing Currency in Global Trade: New Evidence**." *Journal of International Economics*, vol. 136, 2022. Also see Carol Bertaut, et al. "**The International Role of the U.S. Dollar**." *FED Notes.* This figure rises to around 50% when intra-euro area trade is excluded from the calculation. Between 1999 and 2019, the dollar accounted for 96% of trade invoicing in the Americas, 74% in the Asia-Pacific region, 23% in Europe and 79% in the rest of the world.

6 Ibid. More specifically, the euro's share in global export invoicing is 46%, about 1.2 times the global share of exports destined for the euro area. The US dollar's share in global export invoicing is 40%, about 4.0 times the share of global exports destined for the US.

7 See Carol Bertaut, et al. "**The International Role of the U.S. Dollar**." *FED Notes.*

8 International loans are those made by banks outside the US to borrowers outside the US. International debt corresponds to the European Central Bank's "narrow" measure of international debt securities – defined as securities sold outside the issuing country, excluding debt in the issuer's own currency.

9 See **Foreign and International Monetary Authorities (FIMA) Repo Facility**. Federal Reserve Board of Governors.

10 See Goldberg, L., and Ravazzolo, F. 2021. "**The Fed's International Dollar Liquidity Facilities: New Evidence on Effects**" *Federal Reserve Bank of New York Staff Reports*, no. 997.

11 See Eichengreen, Barry. "**Two Views of the International Monetary System**." *Intereconomics*, vol. 54, no. 4, 2019. Before the establishment of the gold standard in the 1870s, gold, bimetallic and silver blocs coexisted and interacted under the British Empire, France and Germany, respectively. In the 19th century, the British pound, the French franc and the German mark all accounted for significant fractions of global foreign exchange reserves. For much of the interwar period, the sterling and the dollar contributed equally to the stock of global reserves and trade invoicing and settlement.

12 See Autor, David, et al. MIT, ***A Note on the Effect of Rising Trade Exposure on the 2016 Presidential Election***. Using county-level voting data from the US' 2016 presidential election, the authors find counties with greater penetration of Chinese imports between 2000-14 were associated with significantly larger gains in the Republican vote share relative to 2000. Also see Davis, Bob, and Jon Hilsenrath. "**How the China Shock, Deep and Swift, Spurred the Rise of Trump**." *The Wall Street Journal*, 11 Aug. 2016. According to a WSJ analysis of the 2016 Republican presidential primary races, former President Trump won 89 of the 100 counties most affected by import competition from China.

13 See Hélène Rey, et al. "**Exorbitant Privilege and Exorbitant Duty**."

14 See Atkeson, Andrew, et al. **The End of Privilege: A Reexamination of the Net Foreign Asset Position of the United States**. Federal Reserve Bank of Minneapolis. April 2022.

15 See Farhi, Emmanuel, and Matteo Maggiori. 2018. "A Model of the International Monetary System." Quarterly Journal of Economics 133 (1): 295-355.

16 See Chen, Aizhu. "Vast China-Russia resources trade shifts to yuan from dollars in Ukraine fallout." *Reuters*, 11 May 2023. According to the report, nearly all of China's purchases of Russian oil, coal and some metals are now settled in the renminbi instead of dollars.

17 See Syropoulos, C., G. Felbermayr, A. Kirilakha, E. Yalcin, and Y.V. Yotov, 2022. "The Global Sanctions Data Base - Release 3: COVID-19, Russia, and Multilateral Sanctions," School of Economics Working Paper Series 2022-11, LeBow College of Business, Drexel University. Figures exclude multilateral sanction targets (for example, the League of Arab States). Four of the 74 countries under US financial or trade sanctions in 2022 were targeted under a broader multilateral sanctions effort that included US allies. The remainder were the subjects of unilateral US sanctions.

18 A CBDC is a digital liability of a central bank that can be used for payments. CBDCs are managed on a digital ledger, which can be a blockchain but does not have to be.

19 See Oliver Wyman and JPMorgan. "Unlocking $120 billion value in cross-border payments." 2021. Today's cross-border payment industry is inefficient: to move $23.5 trillion across countries, corporations pay each year $120 billion annually, the equivalent to the GDP of Kuwait. Money often moves through many banks with different opening hours, messaging standards, and IT systems before reaching their destinations, a process known as correspondent banking.

20 These projects are known as Project Hamilton and Project Cedar.

21 See Central Bank & International Account Services. Federal Reserve Bank of New York.

22 A retail CBDC is a CBDC available to the general public.

23 See SWIFT Institute, The Future of Correspondent Banking Cross Border Payments, 19 October 2018.

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Faulkender Responses to Questions for the Record from Ranking Member Maxine Waters Subcommittee Hearing, entitled "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency"

Thank you for the questions you have sent to me.

The most effective sanctions are those for which there is concurrence among our allies and that have few exceptions. Our ability to impose sanctions rests on the fact that such a large percentage of international transactions are denominated in dollars and flow through US financial institutions. When there is consensus among allies on the imposition of sanctions, there is cooperation between large financial institutions and governments to implement those sanctions. When done unilaterally and over the objection of allies, it creates a potential incentive to facilitate bypassing the sanctions and undermines the willingness to continue having the US dollar at the center of international commerce. Additionally, when exceptions to sanctions are allowed (such as payments for Russian natural gas), such exceptions create an incentive to relabel transactions as related to those exceptions. In order to create the greatest impact, the US and its allies must be willing to completely cut off the nation or government that is being sanctioned, else leakage through exceptions can make the sanctions largely meaningless. In addition, tit-for-tat sanctions that symbolically go after individuals undermine the legitimate use of this foreign policy tool, particularly when the individual sanctioned can easily transfer money through unsanctioned associates.

As stated in my testimony, the dollar's status as the world's reserve currency comes from having liquid financial markets with the free flow of capital, responsible stewardship of the nation's economy, continual updating of the technology underlying the payment system, and the conservative use of sanctions that have widespread consensus. The size of our economy and our economic engagement around the world has led to major commodity transactions, such as oil, to be almost exclusively exchanged in US dollars. The first major inflection point I would be concerned with is if international oil transactions were to be quoted and traded in significant quantities in currencies other than the US dollar. Such international trade in dollars necessitates reserve banks around the world to hold dollars to facilitate such trade and were those transactions to be done in other currencies, it would diminish the need to hold such large quantities of dollars. Currently, there is not a viable substitute for the dollar but our economic stewardship and our foreign policy should not invite others to create viable substitutes.

China has a long history of stealing intellectual property, forcing technology transfers to gain access to its markets, and manipulating its currency to give it advantages in international trade. Recognizing these actions, the US Treasury designated China a currency manipulator in 2019, triggering consultation with the International Monetary Fund to coordinate a response. While the impact was marginal, it is important that the US more aggressively combat China's abuses and engage international partners to do so. We must re-examine their membership in the World Trade Organization, preclude it from being a recipient of World Bank and IMF loans, and enforce the trade agreement negotiated by the last administration. Declaring them to be a currency manipulator should be part of the campaign to address the abusive practices of China.

Questions for the Record from Ranking Member Maxine Waters
Subcommittee Hearing, entitled "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency"
June 7, 2023, 10:00 a.m.

Dr. Daniel McDowell

1. Which of the following options best describes your self-identified race? (you may choose more than one)
   a. **White or Caucasian**
   b. Black or African American
   c. Hispanic/Latinx
   d. Asian
   e. Middle Eastern/North African
   f. Choose not to answer
   g. Prefer to self-describe (please specify)

2. Which of the following options best describes your gender identity?
   a. Woman
   b. **Man**
   c. Non-binary
   d. Transgender Man
   e. Transgender Woman
   f. Choose not to answer
   g. Prefer to self-describe (please specify)

3. In your most recent book, Bucking the Buck: US Financial Sanctions and the International Backlash Against the Dollar, you discuss the trend of central banks, like those in Russia, China, and Turkey, becoming net buyers of gold. This is after a solid twenty years of the same banks being net sellers of gold. Can you explain why you think this is and the role that U.S. sanctions may be playing in this shift?

   Gold is unique because it is accepted as a central bank asset, and yet is distinct from other FX assets which are fiat money. Gold reserves are also a physical commodity that can be held within a country's own vaults on its territory, meaning it cannot be "frozen" by Western countries via sanctions. It can be moved around the world, outside of financial networks, making it difficult to track or "block" through sanctions. Gold can be melted down and reformed, making it hard to identify its true origins. For these reasons, states that are worried about sanctions find gold appealing as an investment option. Gold cannot replace dollars, or other FX assets. It has real downsides. Physically storing gold and physically moving gold have real costs, and are difficult. Gold stored in national vaults is not highly liquid. But it is highly secure, and capable of evading sanctions in ways that other assets are not. Despite its downsides, Russia's gold reserves proved to be safer than its US Treasury bonds or euro holdings, which are now useless to Putin. Gold

cannot solve the problem of sanctions for targeted states, but it can securely store wealth.

4. All of the panelists at this hearing mentioned the need to use sanctions wisely. Are there specific sanctions regimes that you believe are outdated or which should not be used? Are there types of sanctions that you believe that Congress or the Administration should not initiate? Could you please explain for any program named?

My comments focused entirely on financial sanctions, and so my comments here will do the same. My own view is that financial sanctions are a powerful tool that should not be used for "symbolic" reasons—to signal to the public (foreign or domestic) that the Untied States is displeased with a specific foreign government or leader. Sanctions are best reserved for situations where the national interests of the United States and its allies are seriously threatened. In such circumstances, policymakers should support financial sanctions when they are confident that the use of the measure has a good chance to (1) change the target's behavior or (2) degrade the target's capabilities over time. If there is little chance that the sanctions will accomplish either of these goals, then the use of the dollar and the US financial system as a coercive tool ought to be reconsidered, and other policy measures should be in play. Finally, the United States should be cautious about the use of sanctions against China for reasons that fall outside of serious national security threats. China is unique in that it is an adversary that is capable of becoming an alternative currency/financial network service provider. While the yuan will not challenge the dollar for global supremacy, provoking China to invest more energy into developing an alternative financial network should be avoided when possible. Sanctions against China may one day be necessary, and appropriate, but the United States would be wise to limit provoking China to spend more time preparing for that moment.

5. Looking at Russia, following sanctions for its invasion of the sovereign nation of Ukraine, and China, which is watching the geopolitics of the global reaction to the invasion play out, we may see an increased appetite for not just alternatives to the U.S. Dollar but alternative mechanisms to move and hide funds. This includes the movement of funds through ecosystems that may be less transparent and which enable targeted actors and governments to evade sanctions.

    a. Can you please comment on the role of emerging financial technologies like alternative payment ecosystems (such as Alipay or WeChat Pay), central bank digital currencies, and non-SWIFT platforms in enabling sanctions evasion?

        1. *Alipay and WeChat are consumer payment solutions and not a significant concern for cross-border sanctions evasion. CBDCs remain more of an idea today than a reality, though it is possible in time interoperable wholesale CBDCs could emerge as a legitimate*

cross-border payment option for sanctioned governments. My own view is that such systems are likely to take years to develop and, once they do, will remain limited in scope for some time. I do believe that Congress should keep a close eye on the development of China's Cross-Border Interbank Payment System (CIPS) which is essentially a Chinese effort to replicate the US-based CHIPS correspondent banking network. In the near-term (next decade) this is better positioned to take some market share from the US dollar in cross-border payments. If China aggressively pushes the use of CIPS with its trade partners, more traffic may migrate to that system. While CIPS remains heavily dependent on SWIFT for messaging, that may change in time, as China recognizes this is a vulnerability.

b. How should the U.S. government respond?

1. *As a first step, it would be wise for US intelligence officials to track which banks are "indirect participants" on the CIPS network. From 2015-2019, CIPS would sporadically release information on banks, though most were not publicly announced. Over the last several years, it has not released those details, so we do not know which banks are included in the nearly 1,400 foreign banks in 111 countries that are part of the network. Mapping this network would be a necessary first step in considering how the US might work to disrupt its functioning.*
2. *In the event of a maximum sanctions pressure campaign on China were there to be some significant security crisis, the United States could use the threat of secondary sanctions to push some of those banks to withdraw from participation in the network. But this would only work if the United States had an accurate map of the network.*
3. *Short of this extreme scenario, the United States may want to express to friendly governments that it is monitoring the development of the network, and that banks in these countries joining the CIPS network is viewed negatively from Washington's perspective. Slowing the growth and use of the network would stunt Beijing's ability to insulate itself from future US sanctions.*

6. Sanctions that are made possible by the strength of the U.S. dollar could push countries to reduce their use of U.S. dollars and minimize the global economic power of the United States. Governments could experiment with other national currencies to proactively shield their economies from the U.S. What inflection points would signal that major economies are making serious attempts to de-dollarize? How should U.S. policymakers address that scenario?

   Evidence of significant reserve diversification away from the US dollar, or the invoicing and settlement of trade in non-dollar currencies, would indicate de-

dollarization. The US should commit to maintaining a stable dollar and open financial markets. Despite growing anti-dollar sentiment, our markets and currency are the envy of the world. We should avoid "own goals" and continue to provide secure, liquid markets to foreign investors (official and private alike). Efforts to update and increase the efficiency of the dollar-based payment system would also be helpful. This does not necessarily mean a dollar-based CBDC, but moving a real-time/same-day cross-border payments would help to reduce the appeal of any alternative, non-dollar based systems that may seek to gain market share through improved efficiency.

Questions for the Record from Ranking Member Maxine Waters
Subcommittee Hearing, entitled "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency"
June 7, 2023, 10:00 a.m.

Dr. Carla Norrlöf

1. Which of the following options best describes your self-identified race? (you may choose more than one)
   a. White or Caucasian
   b. Black or African American
   c. Hispanic/Latinx
   d. Asian
   e. Middle Eastern/North African
   f. Choose not to answer

2. Which of the following options best describes your gender identity?
   a. Woman
   b. Man
   c. Non-binary
   d. Transgender Man
   e. Transgender Woman
   f. Choose not to answer
   g. Prefer to self-describe (please specify)

3. All of the panelists at this hearing mentioned the need to use sanctions wisely. Are there specific sanctions regimes that you believe are outdated or which should not be used? Are there types of sanctions that you believe that Congress or the Administration should not initiate? Could you please explain for any program named?

   Many considerations are likely to figure in the United States' use of sanctions. With regard to this question, I assume the core concern is for the United States to reduce sanctions blowback on the unipolar currency order. Using sanctions to enforce key norms underpinning international order, the United States violates transgressions in the form of financial crimes, human rights abuses, corruption, electoral interference, terrorism, and wars. Protecting these global public goods is in the interest of most currency majors, and many other states, even states that do not use sanctions as a policy tool. Whenever possible, sanctions should therefore be imposed in a multilateral coalition, enhancing their legitimacy and effectiveness. However, pressuring states into sanctioning coalitions or shaming states when they do not participate is likely to alienate states otherwise supportive or agnostic about the utility of sanctions. The yardstick for determining whether the United States can impose sanctions without backlash against the dollar system is not whether sanctions are backed by multilateral coalitions. The real barometer is whether the US is using its sanctioning powers to shore up international order, as opposed to pursuing narrow interests from which specific interests in the United States derive benefits. Imposing

sanctions to pursue narrow U.S. interests raises concerns about their legitimacy, motivating countries to find alternatives to the dollar. In many cases, the absence of sanction partners can indicate that the United States is pursuing parochial interests, but it is also possible that the US finds itself imposing sanctions unilaterally because other countries are free riding on US efforts to protect global public goods. Unilateral actions are not necessarily synonymous with parochial objectives.

As a tool of economic statecraft, sanctions are effectively a failed influence attempt since their imposition is only warranted if the target has failed to comply with a stated policy. The punitive action is not a goal in and of itself. The objective is rather to modify behavior or reform a policy. To that end, the United States must ensure its sanctions policy meets two conditions. First, when imposing the sanction, the desired behavioral and policy changes must be clearly stated. Second, if the terms are fulfilled, the sanction must be lifted without stipulating additional terms for removing the sanctions. If the United States deviates from these guidelines, the sanctions regime will appear arbitrary, reducing the likelihood of compliance, and eroding the efficacy of sanctions as an instrument of economic coercion, thus raising the risk of dollar backlash.

In addition, the US should acknowledge that sanctions have unintended consequences. Whenever feasible, the United States should take steps to alleviate unintended effects on third parties. The collateral damage endured by innocent bystanders can be substantial and generate resentment and anti-Americanism. More on this point in response to question 5.

4. Can you comment on which CBDC projects have had or will have the most notable impact on the U.S. Dollar's role, and how, whether positive or negative?

   As a retail central bank digital currency, the digital yuan allows individuals and entities to hold digital cash directly with the People's bank of China. On the positive side, the initiative will offer more accessible, cheaper, faster transactions than transactions which involve the central bank, sending and receiving banks and correspondent banks. On the negative side, the ability to prevent sanctions evasion or otherwise illicit transactions depend on China's law enforcement efforts since transactions in the digital yuan need not be funneled through US banks or SWIFT. Therefore, the digital yuan could undercut the United States' ability to use sanctions to enforce international order. The digital yuan could also have indirect consequences for the dollar's global role by facilitating capital account liberalization, making the yuan more freely available, due to the Chinese central bank's ability to monitor transactions and manage destabilizing capital flows. Large-scale foreign use of a digital yuan could result in spontaneous yuanization in less stable economies. If payment efficiencies contribute to structural changes, raising Chinese internal demand, reduces or shifts Chinese supply of goods and services away from the US, the dollar's international role could be negatively affected.

A digital euro will have the same positive features as a digital yuan with less downside with respect to enforcement of sanctions and illicit financing given the shared objectives and close collaboration between the euro-zone and the US. The consequences for dollar dominance could prove sharper however, given the widespread use of the euro, and the relatively stable economies jointly providing euros via European Central Bank issuance, making euroization more likely if foreigners are allowed access. Offering a digital euro to foreigners could however prove challenging from a law enforcement perspective.

China's wholesale CBDC initiative could facilitate a move away from US-centered payments systems if foreigners find such arrangements more efficient and, or, politically expedient—with potentially negative consequences for the dollar's dominance, and the ability for the United States to enforce international order. Adverse effects on the dollar's international role are however highly contingent on underlying shifts in investment and trade patterns and the willingness of parties to adopt the Chinese yuan in economic exchange beyond their bilateral relationship with China.

5. Looking at Russia, following sanctions for its invasion of the sovereign nation of Ukraine, and China, which is watching the geopolitics of the global reaction to the invasion play out, we may see an increased appetite for not just alternatives to the U.S. Dollar but alternative mechanisms to move and hide funds. This includes the movement of funds through ecosystems that may be less transparent and which enable targeted actors and governments to evade sanctions.

    a. Can you please comment on the role of emerging financial technologies like alternative payment ecosystems (such as Alipay or WeChat Pay), central bank digital currencies, and non-SWIFT platforms in enabling sanctions evasion?

Emerging financial technologies could be used to evade sanctions because they are opaque and, or, operate outside and even separately from US dominated payments arrangements. Mobile payment transactions are difficult to trace, explaining their popularity for sanctions evasion, money laundering and foreign influence campaigns. Local payments systems may allow a sanctioned country to perform domestic transactions, and to a more limited extent foreign transactions, when foreign payment networks withdraw from the sanctioned country. Russia's use of MIR to undercut the impact of VISA and Mastercard's departure following Russia's 2022 invasion of Ukraine provide a precedence for this type of loophole. Central bank digital currencies, and alternative payments arrangements and platforms such as CIPS (China's Cross-Border Bank Payments System) or Russia's System for Transfer of Financial Messages (SPFS) escape the United States' jurisdiction to monitor transactions.

    b. How should the U.S. government respond?

The US should minimize the risk of sanctions backlash by raising sanctions legitimacy, providing cost benefit reviews of sanctions impact and by ensuring judicious practices

when sanctions are imposed. Much public attention focuses on the negative consequences sanctions have on innocent civilians, a rightful concern. The context in which sanctions are imposed is given much less consideration. To balance the one-sided view of sanctions, the US should provide public reviews of the net impact of sanctions. For example, in the case of sanctions imposed to counter human rights abuses, the review would provide data and analysis of the country's human rights record before and after the imposition of sanctions and detail the cost of sanctions in terms of material deprivation. Transparency about the setting in which sanctions are levied and their net effect is likely to provide a more nuanced picture of the entities under US sanctions. The reviews should be organized thematically according to policy objective, to emphasize the United States' commitment to uphold global public goods.

In terms of how sanctions are imposed, the US should ensure that sanctions are used as a last financial resort with clearly communicated steps required to meet US demands and trigger actions to signal the need to remove sanctions once US demands have been met.

The US should not actively work to prevent other countries from experimenting with, or completing, alternative payment arrangements but could take steps to derail their attractiveness, discussed below under question 6.

6. Sanctions that are made possible by the strength of the U.S. dollar could push countries to reduce their use of U.S. dollars and minimize the global economic power of the United States. Governments could experiment with other national currencies to proactively shield their economies from the U.S. What inflection points would signal that major economies are making serious attempts to de-dollarize? How should U.S. policymakers address that scenario?

   Dollar dominance will erode if shifts in trade and investment patterns make the US less central for cross-border economic flows. A waning role for the dollar is likely if weaker commercial and financial ties with the US coincides with stronger economic ties between countries open to alternative platforms raising incentives for them to transact in alternative currencies using alternative arrangements. Profound political changes, for example the demise of US political institutions due to extreme polarization, remarkably erratic foreign policies including sanctions policy could also dent the dollar's global role.

   If US policymakers wish to preserve dollar dominance, they should move proactively to prevent structural changes in the global economy by using positive economic inducements in addition to sanctions. Expanding trade and investment will bring more countries into the US orbit, and deepen existing ties, creating more incentives for private and official entities to continue holding and transacting in dollars over US-centric platforms. In the short-term trade adjustment assistance programs, with an emphasis on re-employment services, can assist in mitigating negative repercussions on the import-competing sector. Over the long

term, vocational education and training can help ease labor force transition into activities where the US is competitive.