IJMSRR
E- ISSN - 2349-6746
ISSN -2349-6738

A STUDY ON US DOLLAR AS A GLOBAL CURRENCY AND RECENT TRENDS OF ITS DROPPING DOWN IN THE INTERNATIONAL FINANCIAL SYSTEM.

Dr. Lakshmi
Assistant Professor, Department of Management T.John College, Bangalore.

Abstract
The volume of Global financial market is increasing because of the growing integration of the different country's economies. An effective International Monetary policy is essential for the smooth transaction of goods and services across the world and effective monetary system is necessary for the rational use of resources and utilise the possibilities of higher consumption . An international monetary system requires an effective balance of payments adjustment mechanism which is important for the assessment of deficits and surpluses in a short time.

At the beginning, International gold standard was used for the open trade and payments, which helped to relate currencies with gold which is an internationally acceptable asset .This standard has become insolvent at the beginning of the I^{st} world war and in 1920 exchange rate has come in to practice, Britain tried to restore the gold standard by accepting the par value of it. The United States had the largest gold reserves at that time. Summit at Bretton Woods by the developed countries took decision to peg the exchange rate to the U.S. dollar. The 1944 Bretton Woods agreement allowed the countries to relate their currencies with Dollar and the dollar has come to its current position.

When the countries were in need of gold for the dollars they held in the early 1970s, Nixon was not ready to do so and separated the dollar from gold. By this time, the dollar had already become the world's dominant reserve currency. However, differentiating the dollar from its gold-based value created stagflation. That's a combination of inflation and stagnant growth. Stagflation was a result of unpegging of Dollar from its gold value. Due to this many countries were ready to drop the dollar as a peg in global trade.

This paper tries to discuss on how dollar has become global currency and the changes that happened recently in considering US dollar as the international currency.

Introduction

US Dollar is the most traded currencies in international market .Global currency or International currency is a currency that is transacted globally , without any set borders. A global currency is the one that is accepted as a common currency for trade all over the world. U.S. dollar, Euro, and yen are most popular currencies for international trade . Reserve currency is the another name for global currency .

As of 2018, 62 percent of foreign exchange reserve is in U.S. dollar. This makes U.S.dollar as the most popular global currency.Dollar is considered as the most powerful currency because it is supported by the U.S.economy. Not only that most of the countries peg their currencies to U.S.dollar and around one third of the gross domestic product is from these countries. In foreign exchange market 90% trade is happening in US dollar and around 40% of world's debt is alsoin US dollar. Dollar strength is the main reason for many countries to keep dollar as a reserve currency.The dollar's strength is the reason governments are willing to hold the dollar in their foreign exchange reserves.Recently some of the countries started invest their reserve in foreign currencies.

Literature Review

1.Lan Cao, Currency Wars and the Erosion of Dollar Hegemony, Michigan Journal of International Law,2016,38 Mich. J. Int'l L. 57 . This paper provides the history of the US dollar as a global currency. It analyses how and why the dollar is being changed and how it has evolved as a paper currency from a global currency.

2.Faudot, Adrien & Ponsot, Jean-François, "The Dollar Dominance : Recent Episode of Trade Invoicing and Debt Issuance"Journal of Economic Integration, 2016, Center for Economic Integration, Sejong University, vol. 31(1), pages 41-64.

This paper describes about the asymmetric situation about the global currency in the international financial system. Earlier all the countries pegged their currencies to US dollar. And this paper explains how the changes have happened and now the countries started investing in their currencies.

Evolution of dollar as a global currency

Gold was considered as the international reserve asset and gold standard had been considered for the transactions in the international monetary system till world war I[st] .All the currency values were compared with Gold for the transaction. But at the beginning of World War I[st], Countries underwent great deal of exchange rate flexibility. In the middle of 1920s ,Britain tried to restore gold standard at the par value of pound. Slowly pound has become over valued and it affected the economic activities in 1930s .It affected the sale of their domestic products and led to competitive devaluation. Due to this uncertainty in value of money, and other various actions, International trade has reduced drastically. This economic depression continued throughout 1930s.

This par value greatly overvalued the pound and caused payment difficulties for Britain. With the tremendous decline in economic activity in the 1930s, payment difficulties emerged in many countries. Governments, in desperation to find foreign buyers for domestic products, made them appear cheaper by selling their national money below its real value thus undercutting the trade of other nations selling the same products. This practice, which is known as ‘competitive devaluation’, merely evoked retaliations through similar devaluation by trading by the rivals. Monetary transactions among nations have come down because of uncertainty about the value of money. All these actions led to great reductions in the volume and value of international trade. Financial depression, and the low level of economic activity continued throughout the 1930s.

Fourty four nation’s representatives met In Brettonwood in 1944 and developed a new monetary system known as Bretton wood system. This system was mainly aimed at protection against competitive devaluation, exchange rate stability and economic growth of the country. It has become fully operational only after 1958.Then the countries are settled their international accounts in dollars because at fixed exchange rate that could be converted to gold. The United state was responsible for converting the dollars in to gold. For that, each amount of dollar was supported by a certain amount of gold. Post world war II, around one year Bretton Woods system worked very well. The system was safe because the U.S. owned almost half of the world’s gold reserves. After a certain period of time U.S.‘s economic output started declining and come down to 27% of world’s economic output. Furthermore, balance of payment has come down and public debt also has been increased because of the Vietnam war.

Other countries started recovering from 1950’s and sees themselves subsidising multinationals and supporting U.S.’s living standards. By 1966,gold reserve of non-US central banks has become much higher than United states. Money supply started increasing in 1971.West Germany had to revalue the Mark, so they left the bretten woods system.

It helped the growth of its economy. Switzerland, France and other nations demanded for redumption of dollar for gold. For the protection against other currencies, United States released a report on devaluation of dollar in August 1971. Switzerland also left the Bretton Woods system as the dollar dropped in value against European currencies .This situation forced U.S to leave the Bretton woods system.

President Richard Nixon in 1971 had taken some economic measures to control the inflation called Nixon shock. Some of them were, surcharge for imports, wage and price freezes, cancellation of direct convertibility of dollar to gold etc. The reason behind surcharge was to motivate other countries to think about revalue their currencies. Surcharge and closing up of gold window made massive speculation against the U.S. dollar. This affected the Bretton woods system .

During 1971 dollar was appreciated not because of the fixed exchange rate system but because of the policy mix between the United States and other countries.

Many countries started redefining their control in terms of currency where the dollar had been the world reserve currency. And which is the medium of exchange for copper, oil, and other vital commodities. Recently many countries have come in front and showed their interest in replacing dollar as a global currency.

China has major trade struggle with the US. China’s yuan is largely accepted as a substitute for dollar in international trading. This increases the tension between the countries and have issues in international trading policies also.

Iran also wanted to avoid US dollar as international currency. That is the reason for implementation of American sanctions and global audit against Iran’s oil sector by the US govt.

Gulf countries are also interested to expand their energy market in china and so want to move away from dollar. . Many of the countries, china, Iran, Russia are giving priorities for dropping American dollar. The number of countries those who are supporting the decentralised financial system are against the US dollar system.

One of the other major growing factors in dropping the value of dollar is Gold. Some of the countries like Beijing and Moscow are expecting to back their currencies with gold. It is possible to convert Yuan in to gold through the Shanghai International Energy Exchange.

Conclusion

After World War II Bretton Woods system has come in to existence and most of the countries have accepted US dollar as the global currency and started pegging in US dollar. Even after, serious fault lines were existing in dollar dominated international economic system. Many changes had been happened in Bretton woods system. U.S. deviated from its dollar-gold conversion commitment; this made US dollar a simple paper money. Trust on global currency has come down among the emerging economies. When trust in paper money has come down, the system got damaged. Emerging economies thought about non-dollar system and the countries tried to come up with non-dollar system

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