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

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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.