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The World Tires of Dollar Hegemony

By [Paul Craig Roberts](#)

What explains the paradox of the dollar's sharp rise in value against other currencies (except the Japanese yen) despite disproportionate US exposure to the worst financial crisis since the Great Depression? The answer does not lie in improved fundamentals for the US economy or better prospects for the dollar to retain its reserve currency role.

The rise in the dollar's exchange value is due to two factors.

One factor is the traditional flight to the reserve currency that results from panic. People are simply doing what they have always done. [Pam Martens](#) predicted correctly that panic demand for US Treasury bills would boost the US dollar.

The other factor is the unwinding of the carry trade. The carry trade originated in extremely low Japanese interest rates. Investors and speculators borrowed Japanese yen at an interest rate of one-half of one percent, converted the yen to other currencies, and purchased debt instruments from other countries that pay much higher interest rates. In effect, they were getting practically free funds from Japan to lend to others paying higher interest.

The financial crisis has reversed this process. The [toxic American derivatives](#) were marketed worldwide by Wall Street. They have endangered the balance sheets and solvency of financial institutions throughout the world, including national governments, such as Iceland and Hungary. Banks and governments that invested in the troubled American financial instruments found their own debt instruments in jeopardy.

Those who used yen loans to purchase, for example, debt instruments from European banks or Icelandic bonds, faced potentially catastrophic losses. Investors and speculators sold their higher-yielding financial instruments in a scramble for dollars and yen in order to pay off their Japanese loans. This drove up the values of the yen and the US dollar, the reserve currency that can be used to repay debts, and drove down the values of other currencies.

The dollar's rise is temporary, and its prospects are bleak. The US trade deficit will lessen due to less consumer spending during recession, but it will remain the largest in the world and one that the US cannot close by exporting more. The way the US trade deficit is financed is by foreigners acquiring more dollar assets, with which their portfolios are already heavily weighted.

The US government's budget deficit is large and growing, adding hundreds of billions of dollars more to an already large national debt. As investors flee equities into US government bills, the market for US Treasuries will temporarily depend less on foreign governments. Nevertheless, the burden on foreigners and on world savings of having to finance American consumption, the US government's wars and military budget, and the US financial bailout is increasingly resented.

This resentment, combined with the harm done to America's reputation by the financial crisis, has led to numerous calls for a new financial order in which the US plays a substantially lesser role. "**Overcoming the financial crisis**" are code words for the rest of the world's intent to overthrow US financial hegemony.

Brazil, Russia, India and China have formed a new group ([BRIC](#)) to coordinate their interests at the November financial summit in Washington, D.C.

On October 28, RIA Novosti [reported](#) that Russian prime minister [Vladimir Putin](#) suggested to China that the two countries use their own currencies in their bilateral trade, thus avoiding the use of the dollar. China's prime Minister Wen Jiabao replied that strengthening bilateral relations is strategic.

Europe has also served notice that it intends to exert a new leadership role. Four members of the Group of Seven industrial nations, France, Britain, Germany and Italy, used the financial crisis to call for sweeping reforms of the world financial system. Jose Manuel Barroso, president of the European Commission, said that a new world financial system is possible only "[if Europe has a leadership role.](#)"

Russian president Dmitry Medvedev said that the "**economic egoism**" of America's "**unipolar vision of the world**" is a "**dead-end policy.**"

China's massive foreign exchange reserves and its strong position in manufacturing have given China the leadership role in Asia. The deputy prime minister of Thailand recently designated the Chinese yuan as "[the rightful and anointed convertible currency of the world.](#)"

Normally, the Chinese are very circumspect in what they say, but on October 24 Reuters [reported](#) that the *People's Daily*, the official government newspaper, in a front-page commentary accused the US of plundering "**global wealth by exploiting the dollar's dominance.**" To correct this unacceptable situation, the commentary called for Asian and European countries to "**banish the US dollar from their direct trade relations, relying only on their own currencies.**" And this step, said the commentary, is merely a starting step in overthrowing dollar dominance.

The Chinese are expressing other thoughts that would get the attention of a less deluded and arrogant American government. Zhou Jiangong, editor of the online publication, ChinaStakes.com, [recently asked](#): "**Why should China help the US to issue debt without end in the belief that the national credit of the US can expand without limit?**"

Zhou Jiangong's solution to American excesses is for China to take over Wall Street.

China has the money to do it, and the prudent Chinese would do a better job than the crowd of thieves who have destroyed America's financial reputation while exploiting the world in pursuit of multi- million dollar bonuses.

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He is the author of [Supply-Side Revolution : An Insider's Account of Policymaking in Washington; Alienation and the Soviet Economy](#) and [Meltdown: Inside the Soviet Economy](#), and is the co-author with Lawrence M. Stratton of [The Tyranny of Good Intentions : How Prosecutors and Bureaucrats Are Trampling the Constitution in the Name of Justice](#).

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