OPINION: IS THE DOLLAR BECOMING A PARIAH? - INSIDE SOURCES

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In recent years, there has been a ‘silent run’ on the dollar. Foreign central banks have significantly reduced the share of reserves held in dollars. The ‘silent run’ on the dollar reflects an expanded role for foreign countries in international trade and finance. The most rapid growth has been in the BRICS, named for the original group of Brazil, Russia, India, China, and South Africa. BRICS have promoted the use of their currencies through reserve currency arrangements and their own BRICS payment system.

The ’silent run’ on the dollar also reflects failures in U.S. fiscal and monetary policy. The U.S. has abandoned the fiscal and monetary policies launched during the Reagan years to stabilize the value of the dollar and restore debt sustainability. In the 1980s and 1990s, the value of the dollar was stabilized because the federal government fulfilled its commitment to price stability. By the end of that period, the budget was balanced, and debt stabilized. These policies also brought an end to the Cold War.

Over the past two decades, the U.S. has failed to fulfill its commitment to stable prices and sustainable debt. The government has been incurring deficits and accumulating debt at an unsustainable rate. Monetization of the debt by the Federal Reserve resulted in volatile changes in the money supply and wide swings in interest rates. These changes wreaked havoc in foreign countries relying on dollar-denominated debt, pushing some of them, such as Argentina, to the brink of default.

U.S. trade policy also contributes to the ‘silent run’ on the dollar. Treasury Secretary Janet Yellen describes U.S. trade policy as ‘friend shoring.’ ‘Friend shoring’ is designed to shift supply chains away from the BRICS toward countries supporting U.S. policies. The BRICS have responded by boosting tariffs and trade restrictions on the U.S. and its allies.

Perhaps the most controversial policies have been U.S. sanctions on the financial assets of foreign countries. When Russia invaded Ukraine, the U.S., along with other countries in the Western Alliance, froze nearly half of Russia’s reserves in foreign currencies and gold and severely limited Russia’s access to the International Payments System (SWIFT). In prior years, similar sanctions were imposed on smaller countries, including Afghanistan, Iran, and Venezuela.

Whatever impact these sanctions had on the target countries, they have had unintended consequences for the international financial system. The sanctions imposed by the U.S. increase the risk in holding dollar reserves in all countries, depending on whether their foreign policies coincide with that of the U.S. Sanctions have been imposed on countries with ties to the BRICS, so it is not surprising that these countries are now attracted to the new BRICS reserve currency arrangements and payments system.

As the U.S. and other countries pursue mercantilist policies, the world is fragmenting into competing trading blocs pursuing trade wars and currency competition. Mercantilist policies are diminishing international trade and investment flows, just as they did during the Great

Depression. This proved to be fertile ground for populist leaders of all stripes.

We do not need to repeat the mistakes of the Great Depression. The U.S. must restore its commitment to stable prices and debt sustainability. With debt at $33 trillion, this will be more difficult than it was during the Reagan years. But with stable prices and sustainable debt, the U.S. could shore up the value of the dollar as a reserve currency. This would help stabilize international trade and financial flows and promote peace.

Free trade and investment should again be the centerpiece of U.S. foreign policy. With U.S. leadership, these policies could expand international trade and investment, creating opportunities for all countries to improve the income and wealth of their citizens.

The U.S. must also reform policies that sanction the financial assets of foreign countries. The unintended consequences of these sanctions are undermining the international financial system. If, as many economists predict, we experience another recession, the fragility of the international financial system will be revealed.