# Evolution of Dollar as global currency

## Why in news?

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Many countries, including India, are looking to rely less on the dollar in recent times and hence becomes important to look at its evolution.

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## What was the background?

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- Since the early 19th century, countries struggled to find the best way to settle trade balance.
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- It was not easy as each country had its own currency with no check on more printing.
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- Finally, most countries agreed to settle trade deficits through the exchange of gold and this system continued up to Word War I.
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- Then many countries stopped their currencies' convertibility to gold so they could print more money to finance the war effort.
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- Disappearance of gold as a common anchor led to the collapse of the global financial system and became one of the reasons leading to great depression in the early 1930s.
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- Countries on the winning side of World War II realised the importance of an anchor like gold for promoting stable trade and finance.
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- Thus they agreed to establish a robust global financial system.
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- Britain proposed creating an International Clearing Union (ICU) to keep account of countries' exports and imports.
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- The unit of account for such transactions would be Bancor (French for Bank Gold).

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- Exports would add Bancors while imports would subtract these in a country's ICU account.
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- Limits were proposed on the amount of deficit, and if it exceeded, the country's currency was allowed to depreciate.
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- This method served as a currency neutral system.
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- But the US rejected it and proposed that the new system should rest on both gold and the US dollar.
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- However, no one liked this idea as this would make the dollar the supreme currency of the world.
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- But the view of US, which is also the principal financier of the victorious side of the war, prevailed.
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- This was confirmed by the signing of Bretton Woods agreement in 1944 by all 44 participating nations, except Soviet Union.
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- The member-countries agreed to maintain a fixed exchange rate which could be adjusted if deficits or surpluses persisted.
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- The International Monetary Fund (IMF) was created to lend to member-countries in need of foreign exchange.
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- The price of gold was fixed at $35 per ounce.
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- The US agreed to supply gold at this price in the exchange with dollars held by other countries.
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## How was the de-linking of gold and dollar resulted in dollar supremacy?

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- The gold for dollar system worked during 1950-70.
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- But it came under strain as the US started printing and spending a large value of dollars on post-war reconstruction efforts.
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- When countries holding these dollars went for exchange with gold, the US

gold reserves started vanishing.
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- Gold supply was finite, but the dollar printing became infinite.
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- Thus the US withdrew from its commitment to convert the US dollar to gold.
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- De-linking gold with dollar made the US the linchpin of global finance.
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- Other countries need to earn foreign exchange (in terms of dollars) by exporting goods or services, while the US economy can indulge in printing dollars.
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- This made US Federal Reserve as the central bank of the world and all other central banks must calibrate their policies to be in sync with the Fed's.
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- It could print dollars without bothering about domestic inflation or balance-of-payments as over two-thirds of all dollars in circulation are held outside the US.
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- It could also carry out massive expenditures on military activities and foreign aid to achieve its political objectives.
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- The Soviet Union was the only major country opposing the dollar's status, and that was the main reason for the Cold War.
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- Europe and Japan reluctantly joined the US political and military umbrella, and accepted dollar as the de facto world currency.
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## What is the impact of dollar-centric system?

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- A country's economy, especially developing ones, became ransom to Fed's actions.
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- If Fed increases the interest rate, dollars flow back to the US, and if it lowers rates, dollars move to the countries where there is high growth potential or the possibility of providing higher returns for their investments.
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- Also, trillions of dollars have been loaned to corporates at near zero interest rate, which transfers wealth from the people to corporates.
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- This is a key reason for the concentration of wealth in the top one per cent of the population.
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- US actions are being emulated by China and other countries which have also printed and offloaded large volume of money in the past 10 years.
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- Awash with cheap loans, Chinese firms export subsidised goods with no relation between cost and price.
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- This has distorted the world trading pattern.
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## What are the options before India?

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- Many countries have started settling trade transactions in local currencies in recent times.
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- Germany and France are setting up a Euro based trading system to continue trading with Iran in the wake of the US call to punish countries having any trade relation with Iran.
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- India and Japan recently agreed to raise the value of currency swap from the $50 billion (agreed in 2013) to $75 billion.
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- This means India can now readily borrow up to $75 billion from Japan in exchange for rupees.
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- This was the latest measure taken by the government to dampen the rupee's slide against the dollar.
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- Along with that, India needs to avoid the lure of hot money like US dollar that comes for investment in debt market and shares.
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- Hot money is the flow of funds from one country to another in order to earn a short-term profit on interest rate differences and/or anticipated exchange rate shifts.
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- Also, India needs to reduce its $90-billion annual crude oil import bill.
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- This is possible through transparent regulation, investment in domestic oil exploration and switching to green energy options.

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- Many countries, including the US, have turned from energy importers to net energy exporters using these strategies.
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- Finally, India is batting far below its potential in exports and hence the measures to boost exports must be enhanced.
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- All these measures could reduce India’s dependence on the dollar and could ensure macro-economic stability on the domestic front.
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**Source: Business Line**

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