Currency Wars and the Erosion of Dollar Hegemony

Lan Cao
In recent years, much attention has been paid to the wars in Iraq, Afghanistan, and Syria, and the nuclear ambitions of Iran. Wars and breaches of the peace are of paramount importance and thus are rightly matters of international and national concern. But there are other forces at work, perhaps less conspicuous but nonetheless debilitating to the U.S. and the dollar-based international system, that merit more attention. The dollar’s role in the international economic system and its valuation remain, as a former head of the German Bundesbank called it, “a riddle inside an enigma.”\(^1\) And as John Connally, Secretary of Treasury under President Nixon declared to the world, “the dollar is our currency but your problem.”\(^2\)

The dollar and the international monetary system have been inextricably intertwined. The Bretton Woods system was created by the U.S. after World War II and reflects American domination. Dollar hegemony has been part and parcel of American economic and military power. Although the U.S. economy seems to have emerged strong from the 2008 financial crisis, serious fault lines exist under the American-dominated international economic system. Whether dollar hegemony can continue despite economic volatility or whether it is being eroded and more worryingly, undermined and attacked, by internal and external forces, is one of the main issues examined in this Article.

What does dollar hegemony mean? When I was a child in South Vietnam, my mother hid gold bars and U.S. dollars in a safe because everyone knew that the dollar was as good as gold; it is also lighter and easier to carry than gold bars. When the Communists entered Saigon after South Vietnam collapsed in 1975, they went house to house, hammering open brick walls in search of hidden dollars.

Americans and other individuals carrying the U.S. dollar can rely on its privileged status when traveling abroad. That the U.S. dollar is accepted worldwide not just by banks and hotels but also by local small businesses and street peddlers is a reflection of international trust in the U.S. dollar. Moreover, in international business, the dollar is the top dog currency because importers and exporters settle their transactions in dollars, even when the underlying imports and exports have no territorial connection to the U.S. “Americans can purchase products at a marginally cheaper rate than other nations, which must exchange their currency with each purchase and pay

---


\(^2\) Id.
a transaction cost.”

For example, more than 80 percent of the trade between South Korea and Thailand are set in dollars, even though only 20 percent of their exports are destined for the U.S. Although fewer than 6 percent of Australia’s exports go to the U.S., 70 percent are invoiced in dollars. Oil (and other commodities) is priced in dollars, requiring countries that are oil consumers to accumulate dollars to pay for oil – mostly by exporting their goods and services to receive dollars as payment.

Oil producing countries with excess dollar profits invest them in U.S. debt securities held in Western or U.S. banks. Half of international debt securities are in dollars. And when central banks hold foreign currency reserves, more than 60 percent of such reserves are dollars. The world’s central banks also hold close to $5 trillion of the bonds of the U.S. treasury and other quasi-governmental agencies such as Fannie Mae and Freddie Mac, and because they continue to desire these dollar securities, they are willing to pay more to hold them. As a result, the interest rate the U.S. has to provide on these securities is relatively low. This allows Americans to have “access to a vast supply of credit and permit[s] the public to borrow at lower interest rates for homes and automobiles and the government to finance larger deficits longer and at lower interest rates.” This in turns allows American households to live beyond their means;


4 BARRY EICHENGREEN, EXORBITANT PRIVILEGE 1-2 (2011) (data provided are from the Eichengreen source).

5 This means that a Thai company exporting to South Korea receiving payments in dollars incurs additional cost of converting those dollars into the Thai baht, the currency it uses to pay its workers and purchase its materials. But a U.S. exporter receives payment in the same currency (the dollar) that it also uses to pay its own workers, managers, suppliers, shareholders.


7 By contrast, the U.S. itself is able to purchase oil or any other commodities and products it wishes with the requisite currency – the dollar – simply by printing.

8 Similarly, a Swiss bank accepts deposits in Swiss francs. When it makes foreign loans, it does so in dollars and would need to worry about exchange rate moves. If the dollar depreciates against the franc, the value of its assets (its loans) goes down relative to its liabilities (its deposits). EICHENGREEN, supra note 4, at 3-4. Of course, the Swiss bank can “protect itself by buying a forward contract that converts the receipts on its dollar loan into francs when the loan matures, at a rate agreed when the loan is made.” Id. at 3. But this means incurring additional transactions costs that American banks are spared.

9 EICHENGREEN, supra note 4, at 4.

indeed, this state of affairs means that ironically, “poor households in the developing world ended up subsidizing rich ones in the United States.” Even in 2008, when the world was gripped by the most debilitating financial crisis in more than 80 years, the U.S. federal government was still able to borrow at low interest rates because foreigners believed the dollar to be a safe haven currency amidst a world of great turmoil.

Although it only costs a few cents for the U.S. government to print a $100 bill, other countries have to provide added value in the form of goods or services in order to receive $100 dollars. Approximately $500 billion American currency circulates outside the U.S. which foreigners acquired, not because their governments printed the dollars but because they had had to provide the U.S. with $500 billion of actual goods and services.

This privileged position of the dollar is not intrinsic nor inevitable but is rather a reflection of American domination and conversely, international trust in American stewardship of the dollar and the dollar-based system. But even American allies, such as France’s Charles De Gaulle, have complained about the dollar’s unique status. His finance minister, Valery Giscard d’Estaing, grumpily called it an “exorbitant privilege” available to no other country. This privilege might have made sense after World War II when the U.S. was the undisputed superpower, the largest importer, the primary source of trade credit and the leading source of foreign capital. When central banks around the world needed to stabilize their currencies against the dollar, it also made sense for those banks to hold dollars in reserve.

But in today’s world, both Chinese and German exports exceeded U.S. exports, with American share of global exports only 13 percent. Foreign investment in the U.S. has also decreased significantly, from nearly 85 percent between 1945 and 1980 to less than 20 percent. This diminished economic position of the U.S. can certainly be viewed in benign terms – it is rightfully due to the welcomed economic progress of others – Europe, Japan, China, India, for example.

---

11 EICHENGREEN, supra note 4, at 4.

12 Id. at 5.

13 Id. at 4.

14 Id. at 2.

15 Id.

16 Id.
But the criticism has become more vociferous for other reasons as well. The pressure on the
dollar, needed but unloved by the world, has been building and will erupt at some point.
Simply put, since 1971, when the U.S. unilaterally ended the post-World War II dollar-gold
conversion commitment, the dollar is no longer backed by gold or convertible into gold upon
demand. It is simply paper money issued by the U.S. government. Yet, “US economic
dominance was so assured that even after President Nixon reneged on the dollar’s previously
unshakeable convertibility into gold, amounting to a massive default, dollar demand kept
growing.”

Other countries also question the fairness of a system that facilitates the establishment of one
country’s currency as the international reserve currency for all countries. Consequently, they also
resent the unfair benefits accrued to the U.S. as a result of this system. For example, they
“question whether the U.S. should have been permitted to run current account deficits
approaching 6 percent of GDP in the run-up to the crisis [of 2008].” They question why the
U.S. doesn’t have to “worry about balance of payments crises as it can pay for imports in dollars
the Federal Reserve can just print.” Emerging economies in particular complain that when their
central banks accumulate dollar reserves to finance the expansion of their economies, they were,
in effect, providing cheap finance for the persistent U.S. external deficit.

For years, in the face of Soviet threat, Europe, Japan, and the oil exporting countries depended
on the U.S. for their national security and thus were willing, indeed, were expected, to line up
and defend the dollar when called upon by their American protector. But things have changed.
More and more critics have complained that the U.S. “has not been a worthy steward of an
international currency . . .” because of its heavy debt and chronic budget deficits. There is a
vigorous debate about debt, particularly government debt and what is acceptable and
constructive vs. what is excessive and destructive.

---

18 See infra text accompanying notes . Under the Bretton Woods system, the U.S. undertook to convert dollars
into gold upon demand at $35 dollars per ounce of gold.
19 Halligan, supra note 10.
20 EICHENGREEN, supra note 4, at 4.
21 Halligan, supra note.
22 EICHENGREEN, supra note 4, at 5.
23 For sources discussing the danger of increased debt, see Carmen Reinhart & Kenneth Rogoff, Growth in a Time
of Debt, 100 AM. ECON. REV. 573 (2010); Reinhart, Carmen M., Vincent R. Reinhart, and Kenneth S. Rogoff,
Public Debt Overhangs: Advanced-Economy Episodes since 1800, 26 J. ECON. PERSPECTIVES 69 (2012);
KWARTENG, supra note 23 at 5-6; for skeptics, see Thomas Herndon, Michael Ash & Robert Pollin, Does High
Moreover, financial, not just military tools are becoming powerful weapons in this economically interdependent and multipolar world. One surefire way of undermining a country’s economy is to go after its currency. In 2013, the Xinhua News Agency, China’s state press agency, issued the following denunciation of the U.S.: “instead of honoring its duties as a responsible leading power, a self-serving Washington has abused its superpower status and introduced even more chaos into the world by shifting financial risks overseas . . . .”

The solution for an international system hostage to American domination and abuse: “the introduction of a new international reserve currency that is to be created to replace the dominant U.S. dollar . . . .” That is an explicit challenge to the dollar and the dollar-based system.

Critics contend that it is not only that China and other countries might see the U.S. as irresponsible. Rather, it is also that they are concluding that the system itself – global and multipolar economically yet national and unipolar monetarily – is becoming unstable and even unsustainable. Such systemic internal stress was severely compounded by external stress posed by “the 2008 financial crisis … [which] highlighted the financial fragility of the U.S. while underscoring the strength of emerging markets.”

In response to the impending crash and fear of severe deflation following Lehman Brothers’ collapse, the U.S. Federal Reserve (the “Fed”) since 2008 has printed over $3 trillion of new money. Although the political limits of frenetic dollar printing may not have been reached as far as the U.S. is concerned, as discussed later in this article, this kind of dollar printing has created dangerous cracks in the international monetary system, with countries such as China, Russia and others waiting in the wings to exploit American monetary instability.

It might seem anachronistic to write about dollar troubles when the dollar is currently strong (as of January 2016) or to warn about profound challenges posed by China and others to the dollar-

---


25 Id.

26 EICHENGREEN, supra note 4, at 150.

27 Deflation is a general decline in prices caused by a reduction in money or credit. When cash is scarce and more valuable, businesses and people hoard and save rather than invest, crushing aggregate demand and causing GDP to plunge. Deflation can be caused by a decrease in spending, government, personal or investment. Declining prices can lead to a downward spiral – declining profits, factory closure, increasing unemployment, declining incomes, defaults on loans by businesses and individuals.

based system when China’s economy seems to be decelerating. Despite its weakening economy and stock market plunge in late 2015 and early 2016, China remains the world’s second largest economy with annual growth of 7 percent and impressive employment figures resulting from China’s mostly smooth transitioning from a manufacturing to a more service-oriented economy. Moreover, the sudden yuan devaluation in August 2015 was not a sign of Chinese weakness but actually “a point-blank, double-barreled shotgun blast aimed at U.S. markets.”

Pressured for years by the U.S. to stop devaluing the yuan because a devalued yuan makes Chinese exports cheaper and more competitive against American products, China’s 2015 devaluation could not be faulted because it was ostensibly made under the cover of market forces – China could claim it was playing by free market rules in order to prepare the yuan for inclusion into the basket of world money called Special Drawing Rights (“SDR”) managed by the International Monetary Fund (“IMF”).

The international economic picture is evolving in complex ways. The purpose of the article is to connect the dots, look at long-term trends, and warn about fundamental fault lines and global headwinds that are not immediately obvious – all the more necessary when the economic snapshot of American markets, and relatedly of the dollar, may appear more rosy than it should be.

In a highly influential book, Unrestricted Warfare, written by two Chinese military leaders and published by The People’s Liberation Army of China, the authors recommended that countries without “the dual advantages of money and technology” such as those possessed by the U.S. develop “new concept weapons.” “[A] breakthrough in our thinking can open up the domain of the weapons kingdom at one stroke. As we see it, a single man-made stock-market crash, a single computer virus invasion, or a single rumor or scandal that results in a fluctuation in the enemy country’s exchange rates or exposes the leaders of an enemy country on the Internet, all can be included in the ranks of new-concept weapons.”

As these authors noted in a colorfully worded chapter called “The War God’s Face Has Become Indistinct,” the cause of the debilitating 1997 East Asian currency crisis was the result of “[a] surprise financial war attack that was deliberately planned and initiated by the owners of international mobile capital [which] ultimately served to pin one nation after another to the ground – nations that not long ago were hailed as “little tigers” and “little dragons.” From this

29 Peter Eavis, China’s Economic Turmoil Sends Ripples to Global Markets, N.Y. TIMES, Jan. 7, 2016, at ..
32 Id. at 25.
perspective, the 1997 Asian currency crisis, accompanied by riots and bloodshed from Thailand and Indonesia to South Korea and Indonesia, looked like a Western plot to destabilize the Asian economies. Then Prime Minister Mahathir bin Mohamad of Malaysia lashed out at the currency speculator George Soros and blamed international speculators for “the attempts to push us back by a decade through forced devaluation of our currency, through the rape of our share market.”

The 1997 Asian economic crisis made an indelible impression on China and brought to the forefront the possibility of financial calamity unleashed by currency crises. The authors warned: “financial war is a form of non-military warfare which is just as terribly destructive as a bloody war, but in which no blood is actually shed. Financial warfare has now officially come to war's center stage. . . . The main protagonist in this section of the history book will not be a statesman or a military strategist; rather, it will be George Soros.”

Any attack on the dollar, via massive foreign sell-off of U.S. securities, for example, would drive up interest rates for the U.S. government as well as for everyday Americans (because higher interest rates would be needed to entice people, domestic and abroad, to buy otherwise less desirable securities). Yet, although this possibility and other developments have eroded the efficacy of the post-World War II dollar-based system and threatened to cause significant damage to U.S. national interests, they have occurred without much critical analysis in the international law literature.

To be clear, certain incidents have been noted but few have connected the dots to present a full picture. For example, in the past ten years, the following have been reported, but as separate rather than as a connected accumulation of instances that together, point to the imminence of global financial instability and the increasing reliance by many countries on financial warfare instead of traditional use of force. The search for control of natural resources, gold, silver, commodities and something of value is all the more important when what the post-Bretton Woods system considers of value – paper money – is becoming increasingly abundant, freely printed by governments operating on chronic deficits.

Note the following examples. On October 28, 2008, RIA Novosti, one of the largest news agencies in Russia, reported that Russian Prime Minister Vladimir Putin proposed that Russia and China switch to national currency payments, instead of the U.S. dollar, when engaged in bilateral trade. On November 15, 2008, Reuters covered Iranian conversion of financial


35 Lang and Xiangsui, supra note 31, at 51-52.

reserves into gold while four days later, various news outlets reported that the central bank of China was considering raising its gold reserves by 4000 metric tons from 600 tons to diversify dollar risk. Five years later, China determined that its gold reserves should be further increased to “ensure national economic and financial safety, promote yuan globalization [i.e., the renminbi as reserve currency] and as a hedge against foreign-reserve risks [i.e., a dollar meltdown],” according to Gao Wei, an official from the Chinese Department of International Economic Affairs of Ministry of Foreign Affairs. On March 23, 2009, without referring explicitly to the dollar, the Governor of the People’s Bank of China ("PBOC") called for “an international reserve currency that is disconnected from individual nations and is able to remain stable in the long run . . . .” Over a span of five years, countries such as China, Brazil, India, Mexico, Japan, South Korea, Iran, Russia, and the United Arab Emirates have not only quietly increased their gold holding but have also engaged in currency swap agreements in which they agreed to use each other’s currencies in bilateral or regional trade. In yet another type of deal, countries also agreed to engage in a barter system – Iranian oil for Chinese goods.

Against this background, two developments are particularly important because they show the beginning of the erosion of dollar hegemony. First, note the concerted actions by Brazil, Russia, India, China and South Africa (“BRICS”) to pursue a dollar-alternative path, most notably the establishment by BRICS of a New Development Bank (“NDB”) as a rival to the Western-dominated Bretton Woods system. And second, take as an example the historic gas deal worth


38 Several reputable news sources reported that China will likely raise its gold reserves, adding about 4000 tons, which is about the entire global demand for gold in a year. To put this in perspective, that is about equal to the entire global demand in a year. See Alex Stanczyk, Multiple New Sources Reporting China Will Raise Gold Reserves, Nov. 19, 2008, at http://www.istockanalyst.com/article/viewarticle/articleid/2816478.


41 Najmeh Bozorgmehr, Anna Fifield, and Leslie Hook, China and Iran Plan Oil Barter, FINANCIAL TIMES, July 25, 2011, at http://www.ft.com/cms/s/0/2082e954-b604-11e0-8bed-00144feabd0.html#ixzz1T8N4nYWw. Although the deal was precipitated by U.S. sanctions against Iran which have blocked China from paying at least $20 billion for oil, it has nonetheless resulted in the dollar being bypassed.

42 This is in addition to China’s formation of a China-led Asian Infrastructure Investment Development Bank (“AIID”), which, combined with the BRICS Bank, pose a challenge to the World Bank and the IMF. Lawrence Summers, Secretary of the Treasury under President Clinton, characterized the founding of the AIID “as the moment the U.S. lost its role as the underwriter of the global economic system.” Lawrence Summers, Time US Leadership Woke Up To New Economic Era, FINANCIAL TIMES, April 5, 2015, available at
400 billion, between Russia and China, concluded after ten years of negotiations, to provide the world’s fastest growing economy with the natural gas it needs for the next thirty years, most likely to be transacted in yuan, not dollars, undercutting both the primacy of the U.S. dollar as the top dog currency used in oil trades and its role as the international reserve currency.

These are not random developments. Despite apparent signs of strength – depending on when a financial snapshot is taken – the dollar-based system and indeed, the dollar itself, are increasingly challenged. In a world of fiat money, massive dollar printing via Quantitative Easing (“QE”) by the Fed since the 2008 crisis has had enormous consequences for the U.S. and the rest of the world. First, countries that have held dollars as reserves worry about the value of their dollar holdings. The devaluation of the dollar during QE has resulted in the overvaluation of other currencies – Brazil’s currency, the real, for example, rose to a ten-month high against the dollar in 2010, prompting Brazil’s Finance Minister to declare that “[w]e’re in the midst of an international currency war. This threatens us because it takes away our competitiveness.”

Indeed, because most countries have to export to get U.S. dollars, a strong

http://www.ft.com/intl/cms/s/2/a0a01306-d887-11e4-ba53-00144feab7de.html#axzz3msNDL2Ml. And according to Summers, there has been “no event since Bretton Woods comparable to the combination of China’s effort to establish a major new institution and the failure of the US to persuade dozens of its traditional allies, starting with Britain, to stay out of it.”


45 Fiat money is money whose value is derived from government decree or regulation. By contrast, commodity money is based on the value of the commodity itself, such as gold or silver, which has other uses besides use as a medium of exchange. JOHN MAYNARD KEYES, The Classification of Money, in A TREATISE ON MONEY 7 (1965) [1930]. See also N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 659 (2008) (“Fiat money, such as paper dollars, is money without intrinsic value: It would be worthless if it were not used as money.”).

46 Quantitative easing is a monetary policy used by the Federal Reserve to purchase government and other securities. The Federal Reserve creates new money, increases the money supply and lowers interest rate. By putting more money into the financial system, it is hoped banks will lend it to consumers and businesses to jumpstart the economy and avoid deflation. Relatedly, when more money is created, the value of the currency also goes down. Prices will likely go up – hence no deflation but possibly inflation. Devalued currency also has the benefit of boosting U.S. exports. Michael Janda, Your Questions: Quantitative Easing Explained, Sept. 20, 2012, available at http://www.abc.net.au/news/2012-09-14/what-do-you-want-to-know-about-quantitative-easing/4260828

47 Devaluation is a double-edged sword. Countries like China that rely on exports do not want their currencies to appreciate much because that would make their exports more expensive to others. On the other hand, no one wants a devalued, worthless currency either. But because the U.S. dollar is a reserve currency, its devaluation has global implications, as this Article explains.

currency hurts their exports because it makes their goods expensive to foreign buyers.\textsuperscript{49} Second, despite the creation of so much new money through QE, the U.S. was able to avoid unleashing inflation in the U.S. because inflation was exported to the world instead, causing, as I discuss later in the Article, additional angst with the dollar-based system. QE became an American weapon, especially against China.

Some countries have found ways to fight back. When the U.S. warned Russia about Russian aggression in the Ukraine and Crimea, Russian Presidential Advisor Sergei Glazyev shrugged, noting that “[w]e hold a decent amount of treasury bonds – more than $200 billion – and if the U.S. dares to freeze accounts of Russian businesses and citizens, we can no longer view America as a reliable partner . . . . We will encourage everybody to dump U.S. Treasury bonds, get rid of dollars as an unreliable currency and leave the U.S. market.”\textsuperscript{50}

Attacking a country’s currency means attacking it on many fronts. “The value of a nation’s currency is its Achilles’ heel. If the currency collapses, everything else goes with it.”\textsuperscript{51} Despite globalization, the market for bonds and stocks is still segmented – not so with currency because “stocks, bonds, commodities, derivatives and other investments are all priced in a nation’s currency. If you destroy the currency, you destroy all markets and the nation.”\textsuperscript{52} This Article examines how and why the dollar is being challenged. Part I provides a brief history of the U.S. dollar, showing how it has evolved from something with intrinsic value to something that has no intrinsic value, except via government fiat. Part I traces the evolution of money in the U.S., from its original foundation in commodities and gold and silver coins, to the creation of money via Federal Reserve notes which function as money substitutes, that is, paper instruments that represent gold and silver and presumably can be converted into real money. The aim of Part I is to show that money was originally rooted in something of value and that over time, its value was debased and became more attenuated and symbolic rather than intrinsic.

Part II examines American power after World War II and the rise of the dollar as the preferred currency of the international economic system. It will focus on the dominance of the dollar-centered global economy and discuss the “exorbitant privilege”\textsuperscript{53} the system has given the U.S.

\textsuperscript{49} The term “currency war” has been used to describe competitive devaluations by countries to achieve a low exchange rate for their currencies. But at the same time it is important to realize that no one country wants its currency to be so devalued that it becomes the least valued currency or a worthless currency. Carolyn Cui, Foreign Reserves Slip in Emerging Markets, Raising Risks, WSJ, June 23, 2015. Sales of U.S. dollars are designed to prop up the value of their own currencies.


\textsuperscript{51} JAMES RICKARDS, CURRENCY WARS 145 (2012).

\textsuperscript{52} Id.

\textsuperscript{53} EICHENGREEN, supra note 4.
For example, to protect this system and the privilege it bestows on the U.S., the U.S. pressured American allies, particularly Germany, to refrain from demanding that dollars be exchanged for gold.

The situation today is starkly different. The first serious crack in this system began in 1971 when President Nixon severed the dollar from the gold-dollar link. Once the dollar’s gold convertibility was broken, the dollar has no intrinsic value — yet for years, managed to retain its dominance despite this severance. “For better or worse, contemporary fiat currency systems do not require bullion in order to function. What they do require is faith. ‘Credit’ and ‘credible’ come from the same root word, after all.”54 We come back to the notion of trust.”55 When trust in paper money is eroded, the system cracks further.

But over the years, the U.S. has managed to contain these incipient cracks. Despite its severance from gold, the dollar’s unique status has been ensured by linking it to oil. “Implicitly since 1945 and explicitly since 1974, the U.S. has guaranteed Saudi Arabia’s security in exchange for Saudi support for the dollar as the sole medium of exchange for energy exports . . . .”56 Any country that buys Gulf oil must pay in dollars — hence the term petrodollars. The global demand for dollars continues because the global demand for oil continues. Part II shows that despite the immense advantages the dollar has received as a result of the agreement to price oil in dollars, the stresses and fractures responsible for the rupture of the dollar-gold link continue to this day, exacerbated by internal dysfunction and external challenges.

Part III explores the consequences for the U.S. and the international system if and when the dollar-based system erodes. The dollar faces both endogenous and exogenous threats. Indeed, the decline of the dollar-based system is caused by the convergence of many factors. Some are self-inflicted, that is, a result of a crescendo of debt, deficit and dysfunction. Some may be the inevitable result of other countries catching up to the U.S. so that American absolute dominance is diminished if measured from its heights after World War II. But it is also fair to say that many countries have worked to diminish the dollar’s role as an international reserve, to usher in a different international economic system, and to benefit from this new de-Americanized world.

Part III also studies the 2008 financial crisis and how global economic decline and U.S. actions ironically created a double edge sword, preventing deflation but also precipitating mistrust in and resentment of dollar domination. Through QE, the Fed created new money to buy government bonds and other assets to finance the government’s ballooning deficit. “The world now operates


55 RICKARDS, supra note 28, at 166.

56 Id. at 156.
with a system where money can be created at will or by decree,” increasing debt and deficit. As more dollars are printed, dollars became cheaper. Part III shows how dollar devaluation during the QE period has upset countries with large dollar holdings and produced deep fault lines in the international economic system. Part III also studies the effect of QE on China specifically, a large holder of dollar assets and on other emerging economies generally. China does not welcome the devaluation of its dollar holdings and in fact, sees “[m]aintaining the real value of its reserves [as] one of [its] keys to maintaining internal social control.” China has in fact taken countermeasures to prevent financial loss and to carve, in the long run, an alternative route to the one dominated by the dollar.

Part III also looks at how QE not only devalues the dollar but also exports inflation to many countries, wreaking financial and political havoc in the process. When “the US used its national monopoly on American printing presses to print more money . . ., the money that the US printed to stimulate the US economy did not stay in the US. It flowed out into the rest of the world and generated a lot of financial volatility, which in turn negatively affected the livelihoods of billions of people.” As one commentator analogized, it is as if “America, living in one of the cabins on our global boat, encountered some dirt in its cabin and decided to give it an almighty scrub by using a lot of soap and water. However, as it did so, it swept all its dirty water out of its own cabin and ‘allowed’ it to flow into other cabins on the boat.”

The massive amount of dollars flowing out of the U.S., where interest rate was already close to zero, in search of higher yield in other countries, led to inflation elsewhere. Chen Deming, the Chinese Commerce Minister, charged the U.S. with irresponsible money printing. “Because the U.S.’ issuance of dollars is out of control and international commodity prices are continuing to rise, China is being attacked by imported inflation.” The Chinese government remembers all


58 At the time, QE weakened the dollar abroad. But as Europe and Japan have begun their own QE, the dollar has been rising in value. https://www.chase.com/commercial-bank/executive-connect/currency-devaluation-fed

59 RICKARDS, supra note 51, at 158-59. “The value of China’s massive foreign exchange reserves, the fortunes of exporters and the flows of hot money into the country are all shaped by the [U.S. dollar/renminbi] USD/RMB exchange rate and the international currency system. China has a greater stake in the dollar system than many other countries because of its massive foreign currency reserve and heavy reliance on trade-related growth. China has found itself constrained by the enduring systemic power of the United States and the centrality of the dollar in the international monetary system.” Gregory Chin & Wang Yong, Debating the International Currency System: What’s in a Speech, 6 CHINA SECURITY 1, 3 (2010).

60 MAHBUBANI, supra note 3, at 71.

61 Id.

62 Id.
too well that commodity inflation was also a catalyst of the June 1989 Tiananmen Square protests. And as many commentators have noted, it is not coincidental that civil unrest and riots erupted in Tunisia in early 2011, spreading to Egypt, Yemen and beyond, when poor countries in the Middle East strained their budgets to alleviate the worst effects of food inflation partly caused by American QE unleashed.

Despite the considerable advantages of incumbency and the lack of viable alternatives to the U.S. dollar, it is by no means certain that the U.S. can successfully maintain dollar hegemony. In fact, the dollar almost lost its status as the world’s reserve currency in 1978 – when the Federal Reserve dollar index plummeted and the U.S. Treasury had to issue government bonds denominated in Swiss francs precisely because foreign creditors lacked confidence in the dollar as a store of value.

Although the word “collapse” sounds apocalyptic, the international monetary system has already collapsed three times in recent history – in 1914, 1939 and 1971. Moreover, that one country can make another country’s currency collapse cannot be surprising. The U.S. itself has waged a currency war against Iran, wreaking devastation on Iran and the Iranian currency, the rial. As Part III shows, U.S. sanctions – against Iran and Russia, for example – has also meant, ironically, that alternative non-dollar-based systems are being created by those countries and others as a counterpunch or as a way to bypass those sanctions. Different countries are also entering into bilateral trade, using their own currencies, rather than the dollar, as payment. But more threatening to the dollar’s supremacy is the decision by many to sever the dollar-oil link, which would decrease global demand for dollars.

What could trigger collapse? For example, China could dump its dollar-denominated assets, including US. Treasury bonds, causing a sharp rise in U.S. interest rates, inflation, possibly the collapse of the dollar on foreign exchange markets and destruction of capital formation. But that could also mean economic suicide for China, given its own large dollars holdings. China could also diversify its cash reserves away from dollar-denominated securities of any kind, and even if the yen, euro, and sterling instruments are not deemed appealing, it could acquire, instead,

63 Scott Minerd, US Will Win from Middle East Domino Effect, Financial Times, Feb. 28, 2011, available at http://www.ft.com/intl/cms/s/0/31874f12-4337-11e0-aef2-00144feabde0.html#axzz3lkWrqM1K (“By printing almost $2,000bn dollars and using that money to buy assets, the U.S. created a rising tide of liquidity that has lifted all asset prices, including commodities, and more specifically agricultural products. Just as chronic food shortages were a big catalyst in the 1991 revolution in the Soviet Union, rising food prices have been a catalyst for the social unrest in the Middle East and north Africa.”) See also infra notes and accompanying text.

64 RICKARDS, supra note 28, at 1.

commodities such as gold, oil, copper. Indeed, it has done precisely this. As many have reported, China has been secretly accumulating gold, ranking now as both the largest producer as well as the largest importer of gold.66 One can see that the accumulation of gold by China, as well as Russia, “presages a shift to a new reserve asset.”67 Gold accumulation is a hedge against dollar devaluation or dollar collapse.68 Accumulating gold is a way of “getting out of paper money and into hard assets, while immunizing those assets from a stock exchange closure . . . . [It] is also a hedge against inflation and financial panic.”69

Alan Greenspan, the Fed’s13th Chairman, warned, “If China were to convert a relatively modest part of its $4 trillion foreign exchange reserves into gold, the country’s currency could take on unexpected strength in today’s international financial system.”70 Although a return to the gold standard is not likely to occur in today’s world of paper money and floating exchange rates, Greenspan’s caution about the unique status of gold and its continued relevance bears special scrutiny. According to Greenspan, “gold has special properties that no other currency, with the possible exception of silver, can claim. For more than two millennia, gold has had virtually unquestioned acceptance as payment. . . . No questions are raised when gold or direct claims to gold are offered in payment of an obligation; it was the only form of payment, for example, that exporters to Germany would accept as World War II was drawing to a close. Today, the acceptance of fiat money . . . rests on the credit guarantee of sovereign nations endowed with effective taxing power, a guarantee that in crisis conditions has not always matched the universal acceptability of gold.”71

Indeed, the fact that central banks all over the world still hold gold reserves is proof of its continuing importance even in a world of fiat currency. Not only has Germany begun the process of bringing its gold stored in New York back, it also wants the gold unencumbered. In this post-2008 financial crisis world, “the debate over a collapse of strictly paper-based currency is


67 RICKARDS, supra note 28, at 12.


69 RICKARDS, supra note 28, at 171.


71 Id.
experiencing a renaissance – as is the dispute over the gold reserves.” 72 For example, German Chancellor Angela Merkel rejected the suggestion floated by many euro partners to use Germany’s massive gold reserves as collateral for euro bonds. 73 And China, as Greenspan noted, continued to hold on to its nearly 13 million ounces of gold, even boosting its holdings as it became the world’s fifth-largest sovereign holder of gold. 74

The accumulation of gold and other developments described in Part III together constitute a serious challenge to the dollar-based system. These developments include the establishment of the NDB and other BRICS actions to undermine and replace the dollar with other currencies; the historic gas deal between Russia and China and equally significant, the strategic decision not to denominate the deal in dollars; the increasing international concern over the long term strength of the dollar and the continuing requests by different countries to repatriate their gold holdings from the U.S.; the accumulation of gold by China in particular, whether by mining in China or outside of China.

Although it is beyond the scope of this Article to describe the specifics of a future non-dollar universe, 75 it is a crucial first step that challenges to the system be understood and diagnosed. Already, as of November 2015, the yuan was designated by the IMF as one of five elite currencies in the world, fit for inclusion in the SDR basket of currencies comprised of the dollar, the euro, the pound, and the yen. This development carried not only symbolic weight but also reflected new fault lines in “changing currency dynamics . . . [and] new geopolitical concerns.” 76 As discussed later, the rise of the yuan will make it easier for many countries to bypass the dollar in economic transactions or to evade Western sanctions. 77 And it is likely that if and when the yuan is ready to dethrone the dollar as a premier reserve currency, it would, unlike the dollar, be backed by gold. 78


73 Id.

74 Greenspan, supra note 70.

75 “Within a decade or so, a ‘reserve currency basket’ may emerge, with central banks storing wealth in a mix of dollars, yuan, rupee, reals and roubles, as well as precious metals. Perhaps some kind of synthetic bundle of the world’s leading currencies will be developed, with emphasis placed, after years of western money-printing, on assets backed by commodities and other tangibles.” Halligan, supra note 10.

76 Keith Bradsher, China’s Renminbi is Approved by I.M.F. as a Main World Currency, N.Y. Times, Nov. 30, 2015, at .

77 Id.

As the two Chinese authors of Unrestricted Warfare astutely observed, the disintegration of the Soviet Union was swift and astonishing: “A powerful empire collapsed without a single shot being fired, vividly corroborating the lines of the famous poem by Kipling, ‘When empires perish, it is not with a rumble, but a snicker.’ Not only was this true for the former Soviet Union, today the Americans seem to be following in the footsteps of their old adversary . . . .”

To close the Introduction, I include this apt quote from John Maynard Keynes: “There is no subtler, surer means of overturning the basis of society than to debauch the currency.”

I. A BRIEF HISTORY OF MONEY

A. COMMODITIES, COINS, AND PAPER MONEY

What is money exactly? The noted Nobel economist Milton Friedman defined money simply as “whatever is generally accepted in exchange for goods and services – accepted not as an object to be consumed but as an object that represents a temporary abode of purchasing power to be used for buying still other goods and services.” Money is used as unit of account; a medium of exchange; and a store of value. A dollar bill qualifies as it plays all three roles. It is a unit of account because it is a measure of the value of goods and services. It is a medium of exchange because it is exchanged to acquire something. And it is a store of value because “it is a repository of purchasing power over time.”

The earliest forms of money were commodities – animal skins, livestock, beads, shells, corn, olive oil, tobacco, salt, etc. To be considered money, “it should itself possess value, and it must therefore have utility as the basis of value.” When English settlers arrived in Massachusetts in 1620, they brought English money with them but when their supply ran out, the colonists had trouble finding a substitute because the English monarchs prohibited the export of coins and


79 Lang and Xiangsui, supra 31, at 23.
80 VINCENT BARNETT, JOHN MAYNARD KEYNES 82 (2012)
81 MILTON FRIEDMAN, MONEY MISCHIEF 16 (1992).
84 W. STANLEY JEVONS, MONEY AND THE MECHANISM OF EXCHANGE 19-29 (1875).
85 Id at 32.
because the colonists did not have a mint or permission to establish one. Commodity currency became legal tender. Trade with Native American tribes involved the exchange of furs, skins and other commodities for wampum, snail and clam shells. Because many of these commodities had disadvantages of spoilage and bulk, the colonists continued their search for other forms of money, such as coins. Although they could obtain English coins by exporting, it was easier to get Spanish coins from the West Indies, through smuggling and piracy.

The preference for coins, however, was displaced when the colonies declared independence. Without an adequate supply of gold and silver, also known as specie, to pay for the war, the Continental Congress issued paper money and IOUs or Continentals, and individual colonies also issued their own bills, resulting in “bills trading at a confusing variety of different prices, inflation, and the disappearance of gold and silver from circulation.” The bills constituted a promise of the Continental Congress to pay face value of each bill in silver coin to any holder on demand. Nonetheless, it was widely suspected that the continentals were not truly backed by silver or gold and the paper bills were often refused as payment. Congress passed a resolution declaring that any person who refused to receive bills of credit would be considered an enemy and ostracized from the community. The Committee on the Treasury recommended that the quantity of paper money be reduced to prevent depreciation. “Without solid backing and with rising inflation, the Continentals soon became worthless, thus the expression ‘not worth a Continental.’” Despite efforts by Congress to support the continentals, the market sent a different message: the continentals were discounted, so that those who paid their debt in

---

86 EICHENGREEN, supra note 4, at 10, 190 n. 4. A mint was established by Massachusetts but it was ordered closed by King Charles.

87 Id. at 10.

88 Specie is “monetary gold or silver, whether in the form of bullion (bars) or coins.” [http://www.federalreserveeducation.org/fed101/History/index.cfm](http://www.federalreserveeducation.org/fed101/History/index.cfm). See also FRIEDMAN, supra note 81, at 16.

89 KWARTENG, supra note 23, at 40 (“One popular work of what became known as political economy, translated from French by none other than Thomas Jefferson, and recommended by John Adams, referred to paper money as a ‘theft’ which was ‘ruinous’ since ‘in this money there is absolutely no real value.’” ).

90 EICHENGREEN, supra note 4, at 11.

91 3 J. Continental Cong. 390, 407 (1775). The bill of credit entitled “the bearer to receive Spanish milled dollars or the value thereof in gold or silver, according to a resolution of Congress passed at Philadelphia, November 29, 1775.”


93 13 J. Continental Cong. 492, 493 (1779).

Continental Congress’ failed experiment with paper money was not forgotten at the Constitutional Convention in 1787. Many writers from the founding period wrote extensively about the evils of paper money. John Adams warned that paper money would be “as cheap as oak leaves.” Gold and silver have reliably served as the preferred money of the world all over because supply is limited and “because the people were confident that everyone would always accept them.” William Blackstone explained the value of gold and silver in this way: “Money is a universal medium, or common standard, . . . a sign, which represents the respective values of all commodities. Metals are well calculated for this sign, because they are durable . . . and a precious metal is still better calculated for this purpose, because it is the most portable.”

At the Constitutional Convention, the Framers debated the issue of paper currency and the prevailing sentiment was that “almost all the speakers feared that if the government held broad power to issue paper money, it could not be trusted to avoid disastrous inflation or legislative disturbance of vested money claims.” Article I, Section 8 of the Constitution provides that Congress shall have power “to coin money, regulate the value thereof, and of foreign coin . . . .” Article I, Section 10 provides: “No state shall . . . coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts.”

From then until the Civil War, the federal government did not issue a paper currency. But the

---

95 Gittings & Goldsmith, supra note 92.

96 KWARTENG, supra note 23 at 42. Pelatiah Webster, deemed by some to be the nation’s first economist, wrote that paper currency “‘polluted the equity of our laws, turned them into engines of oppression, corrupted the justice of our public administration, destroyed the fortunes of thousands who had confidence in it . . . and went far to destroy the morality of our people.’”


100 Hurst, supra note 98, at 76-77.

101 U.S. Const. art. I, section 8.

102 U.S. Const. art. I, section 10. See also KWARTENG, supra note 23 at 43.

Civil War, which launched a cash-strapped government into financial crisis, changed the monetary landscape. As the Supreme Court described it, “the public treasury was nearly empty, and the credit of the government, if not stretched to its utmost tension, had become nearly exhausted. . . . The entire amount of coin in the country, including that in private hands, as well as that in banking institutions, was insufficient to supply the need of the government three months, had it all been poured into the treasury.”

Congress used the power to borrow money on the credit of the U.S., enumerated in Article I, Section 8, Clause 2, to create paper money. For the first time since the issuance by the Continental Congress of the Continentals, Congress authorized Demand Notes, printed in $5, $10, and $20 denominations and green in color – hence the name “greenbacks” – which could be redeemed in coins. In 1862, Congress issued new Legal Tender Notes or U.S. Notes also printed with green ink. “Confidence in the notes waned somewhat when the Treasury stopped redeeming them in coins during the Civil War to save gold and silver. However, redemption resumed in 1879 following the war.”

Several important features characterized these notes. They were declared to be legal tender in payment of public and private debts. “Thus, greenbacks were no longer promissory notes redeemable into constitutional money. Rather, they were designed to circulate as the new official currency.” Second, although greenbacks were not redeemable into gold or silver, they had investment value, that is, the holders could convert them into 6% interest twenty-year bonds. Congress thus has “introduced a cycle of monetized paper. The greenbacks could be converted into interest-bearing investment paper, that is, government bonds and certificates. The bonds and certificates were redeemable, but only in greenbacks. In this cycle of conversion, paper for paper, the constitutional coin disappeared.”

Inflation meant that the greenbacks fell in value against gold which raised questions about whether creditors could refuse payment in greenbacks and demand gold. In Knox v. Lee, the

---

105 Flamme, supra note 94. In 1862, Congress passed a bill authorizing the Secretary of the Treasury to issue, on the credit of the U.S., 150 million paper dollars, officially known as U.S. notes. Act of Feb. 25, 1862, ch. 33, 1, 12 Stat. 345.
106 Id.
109 Id. at 424.
110 Id. at 425.
111 In Hepburn v. Griswold, the issue was “whether Congress has [the] power to make notes issued under its authority a legal tender in payment of debts which, when contracted, were payable by law in gold and silver coin.” 75 U.S. 603, 610 (1869).
Supreme Court held that Congress had Constitutional authority to endow what is essentially paper money, called treasury notes, with the legal qualities of money and that the legal tender legislation was constitutionally applicable both to pre-existing as well as subsequent debts.\textsuperscript{112}

This case provoked strong dissent. Justice Clifford observed, for example, that the Framers understood that “gold and silver were adopted to serve the purpose of exchange by the tacit concurrence of all nations at a very early period in the history of commercial transactions. . . . They not only knew that the money of the commercial world was gold and silver, but they also knew, from bitter experience, that paper promises, whether issued by the States or the U.S., were utterly worthless as a standard of value for any practical purpose.”\textsuperscript{113}

The central question is how to make paper money, which is essentially worthless, into something acceptable and valuable in ordinary times, and perhaps more spectacularly, in the case of the dollar, into something that the entire world believes is valuable as well.

\section*{B. CENTRAL BANK, FEDERAL RESERVE AND THE RISE OF THE DOLLAR}

In the early years, the U.S. did not have a central bank. “American banking was a hodgepodge of state-chartered banks with no federal regulation or uniformity in operating laws.”\textsuperscript{114} After the 1907 bank panic, it was determined that without a central bank, the federal government was not able to expand or contract the nation’s money supply to smooth out booms and busts. “In 1913 a major change in paper currency occurred with the passage of the Federal Reserve Act . . .”\textsuperscript{115} creating a Federal Reserve System (“the Fed”) of regional reserve banks guided by a Board whose members would not be picked by bankers but rather by the president and subject to Senate confirmation.”\textsuperscript{116} The Fed’s main role is to serve as a lender of last resort “to furnish an elastic currency . . . and to establish a more effective supervision of banking in the U.S.”\textsuperscript{117}

The Fed creates money through open market operations conducted by the Federal Reserve Bank of New York. When the federal government needs money because it is short of funds, the Federal Open Market Committee approves the purchase of U.S. government bonds, issued by the

\begin{itemize}
  \item \textsuperscript{112} 79 U.S. 457 (1870). Some Founders such as Madison recognized the need to take into consideration national emergencies, whereupon the government would be allowed to issue promissory notes. However, Madison would not allow the government the power to make them legal tender. Khan, \textit{supra} note 108, at 405, 427 (1999).
  \item \textsuperscript{113} Knox v. Lee, 79 U.S. 457, 604-605 (1870).
  \item \textsuperscript{114} Flamme, supra note 94.
  \item \textsuperscript{115} \textit{Id.}
  \item \textsuperscript{116} \textit{RICKARDS, supra note 51, at 51-52.}
  \item \textsuperscript{117} Federal Reserve Act, ch. 6, 38 Stat. 251 (1913) (codified in scattered sections of 12 U.S.C.).
\end{itemize}
Treasury Department, on the open market. The Federal Reserve Notes are issued to the regional federal banks at the discretion of the Board of Governors of the Federal Reserve System.\textsuperscript{118} The Federal Reserve Act of 1913 specifically provided that the Federal Reserve Notes “shall be redeemed in gold on demand at the Treasury Department of the U.S., in the city of Washington, District of Columbia, or in gold or lawful money at any Federal reserve bank.”\textsuperscript{119} A written legend appeared on the face of the Notes – “redeemable in gold on demand.”

World War I provided a significant boost to American finance. Although it was a neutral country, the U.S. provided 75 percent of Britain’s foreign loans.\textsuperscript{120} [“T]he commitment of New York to keeping gold payments ’provided the plainest possible evidence to the outside world that the U.S. was at the moment . . . the one locality in which the world’s floating capital could be safely lodged without fear of depreciation of its value.’”\textsuperscript{121} Because the war damaged the ability of banks in Europe to provide credit, capital to finance trade became scarce. As a result, “German and British banks turned to New York to accept endorsed bills for their clients’ imports not just from North American but from Latin America and Asia as well. The credit they received was denominated in dollars because this was the currency with which the New York banks were familiar.”\textsuperscript{122} “[T]he growing presence of the U.S. in international markets accentuated the need for a national currency for ‘global invoicing, payments, and reserve purposes.’”\textsuperscript{123}

The dollar’s ascendancy was also accelerated by the sterling’s decline. The British government suspended gold payments in 1914 and in 1915, forbade British banks from lending to borrowers outside the British Empire, prompting Alexander Noyes, a noted financial journalist of the 1920s, to declare that by this decision, London “‘ceased to be the money centre of the world.’”\textsuperscript{124} U.S banks quickly expanded abroad and by 1920, American banks had opened 181 branches outside the U.S. – importers accepted drafts in dollars drawn by American exporters; exporters exporting to the U.S. also drew in dollars on U.S. banks.\textsuperscript{125}

\begin{enumerate}
\item \textsuperscript{118} Federal Reserve Notes are authorized by Section 16 of the Federal Reserve Act of 1913 (codified at 12 U.S.C. section 411).
\item \textsuperscript{119} Federal Reserve Act, ch. 6, 16, 38 Stat. 251, 265 (1913).
\item \textsuperscript{120} KWARTENG, supra note 23 at 105.
\item \textsuperscript{121} Id.
\item \textsuperscript{122} EICHENGREEN, supra note 4, at 26.
\item \textsuperscript{124} KWARTENG, supra note 23 at 108.
\item \textsuperscript{125} EICHENGREEN, supra note 4, at 28.
\end{enumerate}
Capital flowed from capital-rich U.S. to capital-scarce Europe as “American banks arranged bond issues for European governments and corporations, denominating them in dollars so they could be marketed to American investors.”126 By 1924 the foreign exchange reserves of central banks consisted of more dollars more than sterling.127

Despite advantages of incumbency, the sterling was speedily displaced after World War I by the dollar. Perhaps it took a shock like World War I and an aggressive, gung ho Fed to displace the sterling. Still, incumbency can only do so much. It is not inconceivable that despite its dominance in today’s economy, the dollar too, under a combination of circumstances, can be displaced.

C. THE DOLLAR IN THE DEPRESSION

The Great Depression had a catastrophic effect on the dollar. Between 1929 and 1933, real output in the U.S. fell nearly 30 percent and the unemployment rate rose from 3 percent to nearly 25 percent.128 The stock market plummeted, banks failed and businesses and household declared bankruptcies. Trade contracted because of a fall in output and spending, and governments everywhere imposed tariffs and quotas to protect domestic industry.129

“[W]ith the decline in international transactions came a decline in the international role of the dollar.”130 “And since the dollars on which foreigners relied to purchase U.S. imports were no longer available, the tendency to hold balances in New York to service such obligations declined commensurately.”131

Globally important currencies suffered during the Depression as well. For example, when the financial crisis spread to Germany, Berlin stopped payments owed to London banks,132 damaging both the London banks’ financial well-being as well as Britain’s balance of payments. Panic set in and by July 1931 a massive amount of gold flowed out of England. With currency depreciation looming, investors took their money out of England, converting it into foreign currency and depositing it elsewhere. The sterling’s depreciation raised fears about the specter of other depreciation, such as that of the dollar.

126 Id. at 31.
127 Id. at 32.
129 EICHENGREEN, supra note 4, at 33.
130 Id.
131 Id. at 34.
132 RICKARDS, supra note 51, at 67.
As Ben Bernanke, Fed Chairman from 2006 to 2014, said, “Central banks as well as private investors converted a substantial quantity of dollar assets to gold in September and October of 1931, reducing the Federal Reserve’s gold reserves. The speculative attack on the dollar also helped to create a panic in the U.S. banking system. Fearing imminent devaluation of the dollar, many foreign and domestic depositors withdrew their funds from U.S. banks in order to convert them into gold or other assets.” In response, “the Fed decided to ignore the plight of the banking system and to focus only on stopping the loss of gold reserves to protect the dollar. To stabilize the dollar, the Fed once again raised interest rates sharply, on the view that currency speculators would be less willing to liquidate dollar assets if they could earn a higher rate of return on them. The Fed’s strategy worked, in that the attack on the dollar subsided and the U.S. commitment to the gold standard was successfully defended, at least for the moment.”

As England and other countries went off the gold standard in 1931, their currencies went down and thus the costs of their exports also went down, making their exports less expensive and thus more competitive than the domestic goods of the importing countries. The U.S. could have engaged in competitive devaluation to devalue the dollar against the sterling and other currencies as well. But devaluation of the dollar would likely have been followed by retaliatory devaluation of the other currencies, resulting in an endless tit-for-tat strategy. “Continuation of paper currency wars on a tit-for-tat basis did not seem to offer a permanent solution. Rather than devalue against other paper currencies, FDR chose to devalue against the ultimate currency – gold.”

But gold was held not only in the Federal Reserve Banks; it circulated privately as legal tender and was also secreted in private safe deposit boxes. Although it was possible for the government to devalue the dollar against gold simply by using the President’s emergency economic powers to declare that gold could be redeemed at, for example, $25 dollars per ounce instead of the gold standard price then of $20.67 per ounce, this benefit would accrue to private gold hoarders. It would not put gold back into circulation. Rather, it could motivate people to use their paper dollars to buy more gold and hoard it in the belief that the dollar could be further devalued and

---

133 Bernanke, supra note 128.

134 Id. See also KWARTENG, supra note 23 at 126 (“the Federal Reserve did precisely the opposite of what modern bankers would have done. They raised interest rates when they should have lowered them.”).

135 Devaluation causes a country’s exports to become less expensive, making them more competitive on the global market. This in turn means that imports are more expensive and domestic consumers are less likely to buy them. If one US dollar equals 93 Japanese yen, a car that costs 2,325,000 yen would cost $25,000 US dollars when exported to the U.S.. BARBARA GOTTFRIED HOLLANDER, HOW CURRENCY DEVALUATION WORKS 42 (2011) But if the yen were devalued so that one US dollar now equals 100 Japanese yen, a car that costs 2,325,000 yen would cost 23,250 dollars. When the yen went down in value, Japanese exports cost less to U.S. consumers, thus boosting the sale of Japanese products.

136 RICKARDS, supra note 51, at 70. For a discussion of actions taken by President Franklin Delano Roosevelt to address the gold-dollar convertibility, see also KWARTENG, supra note 23 at 130-31.
the value of gold would be further increased. “Roosevelt needed to ensure that any gains from the revaluation of gold would go to the government and not the hoarders, while citizens would be left with no forms of money except paper. If gold could be removed from private hands and if citizens could be made to expect further devaluations in their paper money, they might be inclined to start spending it rather than hold on to a depreciating asset.”

For the government’s plan to work, hoarding or possessing gold had to be prohibited. Furthermore, to protect the government’s own dwindling gold reserves, President Roosevelt outlawed all redemption of gold. Joint Resolution of 1933 declared that obligations, public or private, that required payment in gold “obstruct the power of the Congress to regulate the value of money of the U.S. . . .” The Gold Reserve Act of 1934 providing that U.S. currency could not be redeemed in gold was upheld by the Supreme Court in Norman v. Baltimore & O.R. Co. on the ground that Congress had the constitutional authority to regulate currency and establish a monetary system without undue interference by private parties via contract.

Additional measures include President Roosevelt’s Executive Order 6102 which not only banned private ownership of gold by U.S. citizens but also required U.S. persons, with few exceptions, to surrender their gold in exchange for paper money at the exchange rate of $20.67 per ounce. To further increase U.S. hoard of gold, President Roosevelt prohibited the export of gold from the U.S. and ordered U.S. gold mines to sell their production to the government at a price determined by the Treasury Department.

Fast forward to 2016 when the connection between the dollar and gold is completely severed (as discussed below). Interestingly, although Fed notes no longer contain a printed ledger promising redemption on their face, the law still allows for redemption, but not for gold – only for “lawful money on demand at the Treasury Department of the U.S., in the city of Washington, District of Columbia, or at any Federal Reserve bank.” Apparently, Fed notes and “lawful money” are deemed to be different and thus the intriguing question is what is considered lawful money? For example, is gold coin lawful money as referred to in the Federal Reserve Act? Although “the gold coin, first adopted a unit of currency in the Coinage Act of 1849 . . . remains the lawful

---

137 RICKARDS, supra note 51, at 70-71.

138 Id. at 71.

139 Joint Res. of June 5, 1933, ch. 48, 48 Stat. 112.


141 294 U.S. 240 (1935).


143 RICKARDS, supra note 51, at 72.

money of the U.S.,” Congress does not allow the Treasury Department to mint one dollar gold coins. Treasury may mint and sell gold but only for numismatic purposes and the Fed cannot redeem Fed notes at par using these numismatic coins. “To this extent, therefore, lawful money exists in the form of gold coins but not for the stated redemption.”

Consequently, currently, there is in fact no real “lawful money” to redeem Federal Reserve notes. Even when redemption of money substitutes into constitutional currency – gold – was suspended during times of national emergencies, such as the Great Depression, it was still understood that there is a distinction to be drawn between lawful money and money-substitutes. Today, ironically, “paper money is convertible only into another form of paper money . . . ” and the dollar is quintessentially fiat money.

II. THE BRETON WOODS AGREEMENT AND THE RISE OF THE DOLLAR

As noted above, although there was no overarching international monetary system before 1945, “for about 35 years prior to the outbreak of World War I, the major Western countries . . . tied their currencies to gold, so that the rate of exchange among the principal currencies was essentially fixed.” By contrast, the disastrous interwar years were characterized by extreme instability with countries alternating between maintaining and severing the link to gold. As World War II wound down, in July 1944, representatives of forty-four nations assembled in Bretton Woods, New Hampshire, to create a new organization for a post-war financial system.

After World War II, the U.S. experienced unparalleled growth and its currency became the unquestioned top dog currency of the international system. Bretton Woods may be cast as a grand international system, but it reflected American preferences. To the surprise of many, Bretton Woods returned to the gold anchor that preceded World War I. Countries ravaged by war emerged heavily indebted and yet, after the war, the monetary system still preserved the gold

---

145 Khan, supra note 108, at 439.
146 Id. at 440.
147 Id.
148 Id. In the case of silver, “[s]imilar to numismatic gold coins, silver coins are both legal tender and lawful money. Thus, lawful money in the form of numismatic silver coins exists but not for the redemption of Federal Reserve notes.” Id.
149 Id. at 441.
151 RICKARDS, supra note 51 at 79 (2012)
standard – evidencing “the extent to which gold was seen as a symbol of stability.” However, this gold standard came with a new twist. The system was anchored to gold through the dollar at a fixed price of $35 dollars an ounce of gold. “For foreign central banks and governments the dollar was as good as gold, since the U.S. stood ready to sell gold at a fixed price of $35 an ounce.”

Other countries that could have issued international currencies lacked either open financial markets or financial stability, like Germany and France respectively. The French franc was once an important reserve currency but the war in Algeria drained the French central bank which lost two-thirds of its reserves in 1955-1957. By the 1970s, West Germany could have been a legitimate rival to the U.S. but given German history of hyper inflation, the German central bank was preoccupied with tightening monetary policy to curb inflation. It did so the usual way – by raising interest rates. High interest rates, however, predictably attracted international capital seeking higher returns, creating in turn an excess of credit which again stoked fears of inflation. As a result, Germany restricted nonresidents from buying money market instruments by imposing various forms of controls, making the deutsche mark unattractive as a reserve currency.

Similarly, the British sterling never recovered from its decline during World War I. And although Japan became a rising power in the third quarter of the twentieth century and the second largest economy in the world by the 1970s, its currency was never an international powerhouse. Asia still harbored resentment against Japanese colonialism and given the Japanese policy of development via export promotion, “a hypercompetitive exchange rate” had to be maintained to ensure Japanese exports remained cheap and competitive. For the yen to achieve reserve status, foreigners must also be allowed to invest freely in the country, which could have

---

152 KWARTENG, supra note 23 at 4. “The move back to some form of ‘gold exchange standard’ was an attempt to restore a degree of order to a world still devastated by world war and depression.” Id and 149.

153 Id. at 143. Not only was Bretton Woods a fixed exchange rate system, like the pre-1974 gold standard system, it was also a rigid system. “Bretton Woods was even more rigid than the old gold standard, as it required capital controls, whereas the old system had not. Even more restrictive was the prohibition on exchanging currencies directly for gold. Under the gold standard anyone with a banknote could go to the central bank and exchange it for gold.” Id.

154 EICHENGREIN, supra note 4, at 39.

155 Id.

156 Id. at 42-43.

157 Id. at 44.

158 Id.
potentially undermined the government’s industrial policies.\textsuperscript{159}

Thus the dollar became unquestionably the top dog currency. Although central banks could still accumulate gold, the gold supply was limited, which made a currency such as the dollar more appealing. Moreover, the two main producers of gold were despised regimes – the Soviet Union and South Africa – and so accumulating gold would mean benefiting them.\textsuperscript{160}

The dominance of the dollar and of the U.S. meant great economic advantages for the country and the American people. For example, U.S. consumers and investors could buy foreign goods and acquire foreign companies by using dollars that would be freely accepted. At the same time, the U.S. government does not have to worry that the dollars accumulated by foreigners would be redeemed for gold, because foreigners were willing to accept and keep dollars – as dollars were as good as gold.\textsuperscript{161} “This ability to purchase foreign goods and companies using resources conjured out of thin air was the exorbitant privilege of which French Finance Minister Valery Giscard d’Estaing so vociferously complained.”\textsuperscript{162}

Under the original Articles of Agreement of the IMF, pursuant to Article IV (4)(a): “Each member undertakes to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations.” Member states were not allowed to devalue their currencies unless permitted by the IMF, and permission would be granted only in cases of persistent trade deficits and high inflation.

Mandatory contributions to the Fund are payable one-quarter in hard assets (under the original articles, in gold, and under the amended articles, in special drawing rights) and three-quarters in their own currencies.\textsuperscript{163} Each member state is assigned a quota and a country with a large quota is required to make a greater contribution but is also entitled to greater drawing rights from the Fund’s resources.

Countries suffering from balance of payments deficits could draw on this pool to fulfill their obligation to maintain the par value of their currencies,\textsuperscript{164} assuming they meet IMF conditions.

\textsuperscript{159} Id.

\textsuperscript{160} Id. at 39.

\textsuperscript{161} Id. at 41.

\textsuperscript{162} Id.

\textsuperscript{163} Article III(3) of the original Articles of Agreement.

\textsuperscript{164} “One of the main attractions of drawing rights as described above was that they were to have the function of reserves, that is, the resources drawn could be used to settle accounts with creditor countries. Indeed, if a creditor country knew that the debtor country had the right to draw from the Fund up to a stated amount, it might well prolong the credit and not insist on immediate settlement.” Lowenfeld, \textit{supra} note 150.
The dollar’s dominance is reflected in its preeminent position within the IMF. For example, because “only a few members’ currencies were generally acceptable for settlement of international accounts—the so-called ‘freely usable’ or ‘freely convertible’ currencies,” typically the member state with balance-of-payments problems would draw U.S. dollars from the IMF.\footnote{165} Under Article V of the original Articles, the member state would purchase dollars or some other freely usable currency with its own currency and would be obligated to repurchase its own currency within a stated period.\footnote{166}

From 1946 to 1971, the system worked well, and when hiccups occurred, the U.S. assured countries it stood ready to meet “the commitment . . . to buy and sell gold at the existing price of $35 an ounce.”\footnote{167} Concern about the U.S., however, grew as the Vietnam War and the Great Society programs created great strain on the U.S. treasury. Because the value of the dollar was not linked to other currencies but rather to gold, speculators who suspect a dollar devaluation would buy gold and would turn to the London gold market. This market had been defined by the so-called London Gold Pool since 1961, which is a price-fixing albeit open market operation run by the U.S. and other countries which are committed to use their gold and dollar reserves to keep the market price of gold at $35 dollars per ounce as agreed to at Bretton Woods.

The Gold Pool was both seller and buyer, buying and selling as much as needed to maintain the $35 price. By 1965, the pool was mostly a selling operation. As gold supplies fell off, Gold Pool members had to dump gold to keep its price (in dollars) from rising on the London market.\footnote{168}

But the pressure on the dollar continued unabated. For example, denied military ambitions after the war, Germany and Japan focused on their economies, became economic powerhouses, mostly by exporting, and succeeded in accumulating all the dollars they needed. In some ways this was also good for the U.S. because those same dollars could be used to pay for imports of U.S. goods. But this was a double-edged sword. The system was founded on the notion that the dollar was the equivalent of gold. If there are now more foreign-held dollars than U.S. gold holdings, the threat to the system could be serious if foreign holders were all to redeem dollars for gold.

This problem was identified early on by the Belgian economist Robert Triffin and has been referred aptly as the Triffin Dilemma. The Triffin Dilemma stated that if the U.S. did not run trade deficits, that is, if it were not willing to supply the trading system with an unlimited supply of dollars (for countries that received dollars when they exported), trade would contract, growth would be stunted, and the contraction would damage the international economic system. On the other hand, if the U.S. continued to run trade deficits and hence provide an unlimited supply of

\footnote{165 Id.}

\footnote{166 Id.}

\footnote{167 3 Weekly Compilation of Presidential Documents 1599, 18 November 1967.}

\footnote{168 EICHENGREEN, supra note 4 at 51. See also KWARTENG, supra note 23 at 211-12.}
dollars to the rest of the world, confidence in the U.S. ability to convert dollars to gold would diminish.\textsuperscript{169} Pressure on the dollar would not be sustainable in the long run and Triffin recommended that an artificial unit of money be used instead of the dollar which would allow governments to accept them in international transactions.\textsuperscript{170}

Pressure on the dollar was exerted in other ways as well. In 1965, President Charles de Gaulle of France denounced both the Bretton Woods system as “abusive and dangerous”\textsuperscript{171} and the dollar’s prominence in the international monetary system, calling for a return to the classical gold standard, that is, “an indisputable monetary base, and one that does not bear the mark of any particular country. In truth, one does not see how one could really have any standard criterion other than gold.”\textsuperscript{172} France and Spain converted $150 and $60 million of their respective dollar reserves into gold, creating great pressure on the dollar and a huge drain on U.S. gold reserves.\textsuperscript{173}

Fortunately, the U.S. was able to rely on Germany, a Gold Pool country, to support the dollar. Germany was a crucial country because of its large dollar holdings accumulated through trade surpluses with the U.S. German demand for redemption of dollars for gold would have triggered a serious dollar crisis.\textsuperscript{174} But most German politicians sought to preserve the security alliance with the U.S. In a secret letter, the President of the Deutsche Bundesbank assured the Federal Reserve that because “expenditures resulting from the presence of American troops in Germany [could] lead to U.S. losses of gold. . . [.] the Bundesbank . . . has not converted any . . . dollars . . . into gold. . . . You may be assured that in the future the Bundesbank intends to continue this policy and to play its full part in contributing to international monetary cooperation.”\textsuperscript{175}

But even with German cooperation, the dollar continued to suffer from external pressure as other

\textsuperscript{169} Id. at 50. ROBERT TRIFFIN, GOLD AND THE DOLLAR CRISIS: THE FUTURE OF CONVERTIBILITY (1961). See also JOSEPH E. STIGLITZ ET AL., THE STIGLITZ REPORT: REFORMING THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEMS IN THE WAKE OF THE GLOBAL CRISIS 157 (2010) (describing how the Triffin dilemma – the use of a national currency, the U.S. dollar, as the international reserve currency – tends to create excess demand for the currency of the issuer, in this case the United States. This excess demand means the United States has to continue providing liquidity to the world by issuing debt denominated in dollars and continue to run trade deficits which in turn erode confidence in the dollar as a store of value).

\textsuperscript{170} In the 1960s, it was Europe and Japan that accumulated dollars as they rapidly expanded after World War II. Today, it is emerging markets such as China and India, that are rapidly accumulating dollars and worried that their dollar holdings would lose value. EICHENGREEN, supra note 4, at 50.

\textsuperscript{171} EICHENGREEN, supra note 4, at 52.

\textsuperscript{172} RICKARDS, supranote 51, at 82 (2012).

\textsuperscript{173} Id.

\textsuperscript{174} RICKARDS, supranote 51, at 83.

\textsuperscript{175} Id.
countries relentlessly exercised their right to gold claims against the dollar. By March 1968, the Gold Pool collapsed. At $35 per ounce, gold was now valued too low – indeed the problem was “an excess of paper money in relation to gold [and] [t]his excess money was reflected in rising inflation in the U.S., the United Kingdom and France.” 176 With a gold shortage at the price of $35 per ounce, the IMF eventually had no choice but to create a new form of international reserve asset called the special drawing right (“SDR”),177 an asset unbacked by gold or any other tangible commodity and allocated to members in accordance with their IMF quotas. It was “linked to gold at a value equal to one U.S. dollar.”178 Referred to as “paper gold,” it was an asset that could be used to address balance of payments deficits in the same way that gold or reserve currencies had been used.179

On August 15, 1971, however, reality set in. Even allied countries were worried and rumor had it that the Bank of England had requested American guarantees against devaluation of its $3 billion dollar holdings or had asked for conversion of its dollars into gold.180 H.R. Haldeman, President Nixon’s Chief of Staff, wrote in his diary that “‘If we gave it to them, other countries might follow suit. If we didn’t, they might wonder if we had enough gold to support the dollar. In either case, it was a major crisis.’”181

President Richard Nixon declared that the U.S. would close the gold window. Referred to as the Nixon Shock, this move meant that the U.S. would no longer convert dollars held by foreign central banks to gold or any other reserve assets and that it would no longer intervene in the market to maintain the par value of the dollar against gold.182 By July 1973, the central banks stopped intervening in the markets to maintain any particular exchange rate and all the major

176 RICKARDS, supranote 51, at 85.

177 EICHENGREIN, supra note 4 at 56-57. At French insistence, the term Special Drawing Rights was used instead of “reserve drawing rights” to emphasize that the new unit was not a currency but a loan subject to repayment and thus could not be inflationary.

178 Id. at 56.

179 SDRs have their own limitations. They can only be used in transactions with other governments and with the IMF as they are not available for use between governments and private parties. In addition, before SDRs can be issued, members holding 85 percent of the voting power in the IMF had to agree. This was a provision designed to protect against the danger of excessive liquidity creation.

180 KWARTENG, supra note 23 at 217.

181 Id.

182 The ability of other holders of dollars to ask for conversion of dollar to gold ended many years before. RICKARDS, supra note 51, at 86.
currencies were floating.\textsuperscript{183} The IMF declared the death of Bretton Woods, which “officially ended the role of gold in international finance and left currency values to fluctuate against one another at whatever level governments or the markets desired.”\textsuperscript{184}

Despite the collapse of gold convertibility, dollar dominance was nonetheless maintained because Nixon was able to modify the system to prevent the dollar from becoming “simply paper money.” As Representative Ron Paul put it, “a new system was devised which allowed the U.S. to operate the printing presses for the world reserve currency, with no restraints placed on it . . . . U.S. authorities struck an agreement with OPEC to price oil in U.S. dollars exclusively for all worldwide transactions. This gave the dollar a special place among world currencies, in essence backing the dollar with oil. In return, the U.S. promised to protect the various oil-rich kingdoms in the Persian Gulf against threat or invasion or domestic coup.”\textsuperscript{185}

Nixon’s decision to decouple the dollar from gold was the culmination of a “long dark period for macroeconomic policy” which began in the 1960s\textsuperscript{186} when the U.S. embarked on a policy of lax budgets and chronic deficit finance.\textsuperscript{187} The economist Cristina Romer, former chairperson of the Council of Economic Advisors in the Obama Administration, has warned about the danger of “persistent peacetime deficits.”\textsuperscript{188} Even though 1950s policy makers recognized that “slavish adherence to a balanced budget” could be counterproductive, “they also believed that persistent deficits were inappropriate and that policy should aim for balance, ‘if not every individual year, then surely over a term of very few years.’”\textsuperscript{189} But by the 1960s through the present, “[t]he revolution in economic beliefs was strongest among fiscal policymakers”\textsuperscript{190} who believe

\textsuperscript{183} Keep in mind that although “the exchange rates were now different, the system was otherwise the same. Other currencies were still pegged to the dollar, the only difference now being that the U.S. Treasury no longer stood ready to convert dollars into gold for foreign central banks and governments.” EICHENGREEN, supra note 4 at 61.

\textsuperscript{184} RICKARDS, supra note 51, at 92.


\textsuperscript{186} KWARTENG, supra note 23 at 203 (quoting Christina Romer, the American economist).

\textsuperscript{187} By contrast, Presidents Truman and Eisenhower were both in principle committed to balanced budgets. Id. at 201-03.


\textsuperscript{189} Id. at 4.

\textsuperscript{190} Id. at 8 (The 1950s emphasis on the benefits of fiscal discipline was replaced by a view that deficits, even over several years, could be salutary. Moreover, policymakers expressed confidence that deficits would largely take care of themselves by generating rapid growth and hence increased revenues.”). Id. at 9.
essentially that deficits would take care of themselves.\footnote{Id. at 11, \& 12-13, 21-22, 24-25. “Budget deficits would largely take care of themselves by generating faster growth and hence more revenue.” Id. at 21.}

William McChesney Martin, the ninth and longest-serving Fed chairman, serving from 1951 to 1970 under five presidents, warned that “[n]o modern country can have stability and sustained growth without some basis of sound currency. . . . That is why the U.S. has the Federal Reserve System, and why the Federal Reserve is charged with the duty of doing all it can, within its limited powers, to help maintain the dollar's value.”\footnote{Remarks by William McChesney Martin Jr. Reminiscences and Reflections, Speech in Hot Springs, VA, Oct. 17, 1969, Martin Papers, St. Louis Federal Reserve, at 10-11, available at https://fraser.stlouisfed.org/scribd/?item_id=7946&filepath=%2Fdocs%2Fhistorical%2Fmartin%2Fmartin69_1017.pdf#scribd-open.} As Martin warned in 1967, “[w]hen we fall into the habit of perpetual deficit financing the soundness of our currency and the strength of our economy will eventually be undermined,”\footnote{Remarks by William McChesney Martin Jr., speech before the Rotary Club of Toledo, Ohio, June 26, 1967, Martin Papers, St. Louis Federal Reserve, at 4, available at https://fraser.stlouisfed.org/scribd/?item_id=7920&filepath=%2Fdocs%2Fhistorical%2Fmartin%2Fmartin67_0626.pdf#scribd-open.} in which case, the international system too will lose confidence in the dollar.\footnote{Remarks by William McChesney Martin Jr., Good Money is Coined Freedom, speech given before the Economic Club of Detroit, March 18, 1968, Martin Papers, St. Louis Federal Reserve, at 12, available at https://fraser.stlouisfed.org/docs/historical/martin/martin68_0318.pdf.} Indeed, in 1965, when French President De Gaulle called for the dollar’s reserve status to be replaced by gold, it would have meant that the U.S. would not be able to pay its foreign debt in its own currency but would have to do so in gold.\footnote{Paul Viotti, The Dollar and National Security: The Monetary Component of Hard Power 15 (2014). If De Gaulle’s gold standard had been adopted, the U.S. would not be able to pay its foreign debt in its own currency but would have to do so in gold. Nor would it be able to maintain persistent and large trade deficits as it would run out of gold. It would also mean American consumers would need to reduce their purchases of foreign goods. Kwarteng, supra note 23 at 211.}

With the demise of the dollar-gold conversion commitment, the international system shifted to a system of flexible exchange rates, referred to by then German Chancellor Helmut Schmidt as “‘a floating non-system.’”\footnote{Id. at 219.} Currencies are not pegged to any gold value and freely floated against each other, like any other commodity. The IMF Articles of Agreement were amended to reflect this new reality. Under Article IV of the original Articles of Agreement, each member state had been required to maintain its currency within a narrow band around its stated par value in terms...
of gold or the U.S. dollar which was at the time tied to gold. Under the amended Articles, Article IV required only that member states avoid manipulating exchange rates. They were allowed to maintain the value of their currency (i) in terms of another currency or the Fund’s own currency, the SDR (but not gold); (ii) in cooperative arrangements with other members; or (iii) using any other exchange arrangements of the member’s choice. Most developing countries chose option 1, to link with the US dollar or to the currency of their former colonial power. The developed countries chose option 3.

Although the dollar had been devalued by its severance from gold, devaluation had strategic benefits given growing trade deficits with Germany and Japan. And despite devaluation, there was still faith in the U.S. dollar. Holding reserves still meant holding dollars. OPEC continued to price oil in dollars, despite talks about pricing oil in a basket of currencies. If there was dollar depreciation, it was because other currencies appreciated, not because central banks sold their dollar holdings.

Currency crises did arise, but they were for the most part nondollar crises – the 1991 sterling crisis, the 1994 Mexico peso crisis, the 1997 East Asia-Russia crisis. The nondollar crises strengthened the dollar as it was viewed as a safe haven. “It seemed as though it would take either a collapse in growth or the rise of a competing economic power – or both – to threaten the supremacy of the dollar.” In 2010, the perfect storm occurred as the factors identified above converged, deepening and widening preexisting cracks.

III. CURRENT CURRENCY WARS

Today’s financial crisis is not just one in which one currency is devalued against another or against gold. The risk is, rather, a massive loss of confidence in paper currencies altogether and a flight in the long run towards safe havens such as commodities or other hard assets. Part III connects the dots – it looks at the causes of the financial crisis, the U.S. response, international reaction and its impact on the dollar-based system. When countries, separately or concertedly, take certain measures to increase their gold or hard commodities, or to repatriate gold holdings stored elsewhere back home, or when they enter into agreements to engage in regional trade using a currency other than the U.S. dollar, these developments constitute a challenge to the U.S. dollar.

Despite U.S. trade deficits and budget deficits throughout the 1980s and onward, the dollar perversely maintained its top dog status. This irony prompted Otmar Emminger, the former President of the Bundesbank, to declare in awe and frustration that the “the more the American

\[\text{197 RICKARDS, supra note 51, at 95-96.} \]

\[\text{198 EICHENGREEN, supra note 4 at 66.} \]

\[\text{199 Id.} \]

\[\text{200 RICKARDS, supra note 51, at 96.} \]
budget deficit and trade deficit increased, the higher rose the dollar. . . . What would have made all other currencies weak seemed to have strengthened the dollar." 201 Even with the closure of the gold link, the dollar did not become a "normal currency like all the others" 202 but rather, retained "its unique role as a world currency." 203 Nonetheless, Emminger cautioned that the "overpriced dollar will sooner or later have to decline to a more normal level. The crucial question is whether this will become a 'soft landing' or a 'crash landing.'" 204

In the 1980s, the dollar had no rival. Not so now.

Despite economic troubles in Greece and the Euro zone and the 2015 economic slowdown in China, things are different today. The U.S. budget deficit which ballooned because of tax cuts and increased war spending continues without solution in sight. Even in 2003, Alan Greenspan had warned, "‘Far more urgent than tax cuts . . . was the need to address the threat posed by the soaring new deficits.’" 205 At the same time, the combined GDP of the U.S., the European Union and China together constitute almost 60 percent of global GDP. Hence it is not surprising that there are currently three major currencies in the world: the dollar, the Euro, and the yuan. 206

Part A looks at dollar-yuan rivalry and explores how this dysfunctional relationship has serious implications for the international economic system. Part B looks at challenges to the dollar’s singular reserve status.

A. Dollar-yuan Rivalry

This section focuses on the currency war between the dollar and the yuan (rather than the euro) for several reasons. First, unlike Western European countries, China is a rival, not an ally of the U.S. Second, China is a rising global power with global ambitions, political, economic and monetary. Third, China has by word and deed taken steps to dethrone the dollar. Moreover, it is not possible to understand fully the 2008 financial crisis and how it deepened the cracks in the system unless one understands the dysfunctional relationship between the yuan and the dollar.

Even as early as the 1980s, when export was a relatively small part of Chinese GDP, the yuan

---

201 Emminger, supra note 1, at 18.

202 Id.

203 Id.; KWARTENG, supra note 23 at 255.

204 Emminger, supra note 1, at 22.

205 KWARTENG, supra note 23 at 312.

206 RICKARDS, supra note 51, at 98.
was deemed to be undervalued.\textsuperscript{207} Partly to protect its rule as a response to Tiananmen Square protests, the Communist Party had placed primary importance on political stability,\textsuperscript{208} and consequently on job creation, which meant the adoption of a robust export sector and correspondingly a devalued yuan. China embraced six rounds of devaluations over a ten year period,\textsuperscript{209} succumbing to U.S. pressure for an upward revaluation only in the administration of George W. Bush.\textsuperscript{210} As incisively noted, “[f]or the Communist Party of China, the dollar-yuan peg was an economic bulwark against another Tiananmen Square.”\textsuperscript{211}

In a surprising move on August 11 and 12, 2015, after a long period of pegging the yuan to the dollar at about 6.1-to-1, the Chinese government allowed the yuan to fall steeply, with the Chinese currency dropping 1.8 percent, then an additional 1.6 percent against the dollar.\textsuperscript{212} This move prompted additional angst in the U.S. as American officials viewed the depreciation as an attempt by China yet again to boost its exports to gain an unfair trade advantage.\textsuperscript{213} China shrugged off criticism, arguing that it was anticipating IMF inclusion of the yuan in the SDR in late 2015 and was merely allowing the yuan to be “freely usable.” China’s devaluation this time was done under the convenient cover of market forces.

The devalued yuan has had a significant impact on U.S. monetary policy. In 2002, then Fed Chairman Alan Greenspan began a sustained period of extremely low interest rate, adopting a 4.75 percent cut from July 2000 to July 2002,\textsuperscript{214} to accomplish several objectives. Certainly one of the objectives was to offset the technology bubble collapse in the U.S. But another objective was to counteract China’s monetary policy, which critics charged included exporting its deflation

\textsuperscript{207} Id. at 100.

\textsuperscript{208} KWARTENG, supra note 23 at 292 “The Chinese . . . had always maintained that their policy of pegging the yuan to the dollar was not ‘meant to favour exports over imports, but instead to foster economic stability by tying its currency to the US dollar at a constant level.’” Id.

\textsuperscript{209} RICKARDS, supra note 51, at 101.

\textsuperscript{210} KWARTENG, supra note 23 at 296.

\textsuperscript{211} RICKARDS, supra note 51, at 102.

\textsuperscript{212} Neil Irwin, The More China’s Currency Falls, the More It Looks Like a ‘Currency War’ N.Y. Times, Aug. 12, 2015. The yuan selloff prompted the Chinese government to issue assurances that “currently there is no basis for persistent depreciation” of the currency, followed by the central bank stepping in to buy yuan to offset the declines.

\textsuperscript{213} A depreciated yuan would boost Chinese exports and might cause other countries to devalue their currencies. This would weaken American exports and slow American economic recovery. A yuan depreciation could thus hamper any plans the U.S. Federal Reserve has to raise interest rates. Keith Bradsher, China’s Currency Move Clouds its Policy Goals, N.Y. TIMES, Aug. 11, 2015.

\textsuperscript{214} RICKARDS, supra note 51, at 103-04.
to the world through its steady supply of cheap labor. A devalued yuan, resulting in cheap export goods and falling prices, can result in entrenched deflation as businesses and consumers postpone spending, hoping prices will fall further. To spur American spending, the Fed kept rates low.

But Greenspan’s low rate policy created conditions that contributed to the 2008 financial crisis and to the subsequent massive printing of U.S. dollars by the Fed. Predictably, a policy of sustained low interest rates meant that even marginal borrowers would be able to finance dubious deals. It also meant that institutional investors would seek higher yield and higher returns (and venture into the realm of the higher risk instruments) than those offered in risk-free government securities, resulting in an explosion of subprime residential and commercial loan originations and securitizations. These two linked factors, marginal borrowers and the housing market bubble, are two factors that were at the crux of the 2008 financial crisis.

Conversely, low interest rates and the U.S. government’s antidote to the 2008 financial crisis – creating new money – also contributed to the financial crisis to China and elsewhere. This is because the yuan’s exchange rate has been pegged to the dollar. This means that China does not allow the yuan to trade freely on international exchange markets in the same way that convertible currencies such as the dollar, euro, sterling, or yen do. The PBOC tightly controls the use of the yuan as a means for settling transactions. For example, because the dollar is the world’s reserve currency, a Chinese exporter would likely be paid in dollars by purchasers of their export goods or services. The Chinese exporter cannot exchange those dollars for the yuan on its own but must hand over those convertible currencies to the PBOC in exchange for yuan, at a fixed official (pegged) rate. Conversely, when an exporter needs euros or dollars to pay for imports, it can get them via the PBOC, but just what is needed to pay for the imports.

Historically, as Chinese exports grew and China received dollars as payment, the PBOC in turn began buying dollars and dollar assets to achieve several objectives. As widely noted, the Chinese “central bank is a major purchaser of U.S. assets, largely because of its exchange rate

---

215 Id. at 104.


217 KWARTENG, supra note 23 at 319.

218 Id. at 322-332.

policy. In order to mitigate the yuan’s appreciation against the dollar, China’s central bank must purchase U.S. dollars”.

Alternatively, intervention to achieve yuan depreciation is important because a low yuan makes Chinese exports competitive, and thus fits into China’s policy of export promotion. Third, the government saw the accumulation of dollar reserves as an important cushion against the kind of economic havoc wreaked by the 1997-1998 Asian currency crisis.

For those reasons, the PBOC has embarked on a path of dollar accumulation. However, the picture is more complicated because a strategy of dollar accumulation itself required an ancillary strategy of yuan printing. This is because “the PBOC did not just take the surplus dollars, but rather purchased them with newly printed yuan. This meant that as the Fed printed dollars and those dollars ended up in China to purchase goods, the PBOC had to print yuan to soak up the surplus. In effect, China had outsourced its monetary policy to the Fed, and as the Fed printed more, the PBOC also printed more in order to maintain the pegged exchange rate.”

PBOC acquisition of dollars resulted in even more dollar exposure for China. Once the PBOC held those newly acquired dollars, it also needed to invest these dollar reserves and given its traditionally conservative orientation, it preferred to invest in highly liquid securities issued by the U.S. Treasury. Consequently, China possessed a massive quantity of U.S. Treasury obligations, which was estimated by some sources as early as 2011 as $950 billion U.S. dollars.

Chinese appetite for dollar assets was a double-edged sword. It was good for the U.S., as it ensured that American bond yields could remain low because a highly desirable U.S. debt market meant that the U.S. could command lower interest rates. As a Congressional Research Service report observed, “[b]ecause of its low savings rate, the U.S. borrows to finance the federal budget deficit and its capital needs . . . . It therefore depends on countries with high savings rates,

---


221 Niall Ferguson & Moritz Schularick, *The End of Chimerica*, Working Paper 10-037, Harvard Business School, Oct. 2009, at 5, available at http://www.hbs.edu/faculty/Publication%20Files/10-037.pdf. In July 1997, the value of the Thai Baht fell dramatically and would have fallen even more had the Thai government not sharply raised interest rate to defend the currency. This hurt Thai businesses that had dollar debt. The debt became more onerous because the number of baht needed to convert into dollars to repay the dollar debt had skyrocketed.

222 RICKARDS, *supra* note 51, at 106.

223 “Rather than hold dollars, which earn no interest, the Chinese central government has converted some level of its FER [foreign exchange reserve] holdings into financial securities.” Morrison & Labonte, *supra* note 220, at 1.

224 RICKARDS, *supra* note 51, at 106.
such as China, to invest some of its capital in the U.S." Any sign that China may reduce its purchase of dollar-based assets and diversify into other debt instruments would be worrying because “China could use [its dollar holdings] as a political tool against the United States.”

But economists Ferguson & Schularick described as dysfunctional this “world economic order that combined Chinese export-led development with US over-consumption.” Ben Bernanke argued that a “‘glut’ of savings from emerging markets was a key factor in the decline of U.S. and global real-long term interest rates . . . .” Low interest rates allowed Americans to consume more and “worsened the imbalance between savings and investment.” Others observed that without “Chinese willingness to fund America’s consumption and real estate speculation habit, long-term interest rates in the U.S. would almost certainly have been substantially higher, acting as a circuit breaker for the housing bubble.”

When the financial crisis hit the U.S. in 2008, it was clear that urgent action was needed. The traditional approach to strengthening a weak economy in the U.S. has been to increase consumer spending. U.S. GDP was $14.9 trillion in 2011, with 71% coming from consumer consumption, 12 percent from investment, 20 percent from government spending, and minus 3 percent from net exports, which means that the consumer has always played a vital economic role. Interestingly, this picture is the mirror image of the GDP composition of China, where consumption was only 38 percent of the Chinese economy, net exports a positive 3.6 percent and investment 48 percent. Consumption remained low in China because its social safety net is weak, forcing individuals to save for their own health care and retirement.

For the U.S., the usual recipe to invigorate consumer spending has been a “combination of low interest rates, easier mortgage terms, wealth effects from a rising stock market and credit card


227 Ferguson & Schularick, supra note 221, at 2. See also KWARTENG, supra note 23 at 317.

228 Ferguson & Schularick, supra note 221, at 6.

229 Id.

230 Id.

231 RICKARDS, supra note 51, at 128-29.

232 Id. at 129-30.
debt,” but with an overstretched consumer, high unemployment, mortgage default, and business reluctance to invest, the Bush and Obama administrations turned to government spending. However, faced with vociferous Tea Party resistance, the Obama administration looked to export, aiming to double U.S. exports in five years to spur growth. Export could be a strategy if China would agree to rebalance and focus more on consumption – by importing from the U.S..

The IMF was summoned by the G20 to support the “rebalancing,” agenda which the IMF described as playing “a critical role in promoting global financial stability and rebalancing growth.” But despite persistent IMF and U.S. pressure, China did not allow the yuan to appreciate.

By June 2009, the U.S., its patience wearing thin, adopted a different currency strategy some called “a secret weapon” – QE. As in 1971, when the U.S. acted unilaterally to weaken the dollar, starting in 2009 the U.S. was able to increase the money supply and increase asset prices via QE. “Instead of reducing the price of money - that is, cutting interest rates - the Fed increases the quantity of money. It does that by going into the financial markets to buy assets and it creates new money to pay for them.” “The new money swells the size of bank reserves in the economy by the quantity of assets purchased—hence ‘quantitative’ easing.”

As John C. Williams, who became the president of the Federal Reserve Bank at San Francisco in 2011 explained, “if the Fed buys significant quantities of longer-term Treasury securities or

---

233 Id. at 128-29.

234 Id. at 129. High U.S. corporate tax rate also meant many corporations kept their earnings offshore so that new investment took place outside the U.S. and did not count towards U.S. GDP.

235 Id. at 129-30.


238 RICKARDS, supra note 51, at 131.


mortgage-backed securities, then the supply of those securities available to the public falls. As
supply falls, the prices of those securities rise and their yields decline. The effects extend to other
longer-term securities. Mortgage rates and corporate bond yields fall as investors who sold
securities to the Fed invest that money elsewhere. Hence, LSAPs [large scale asset purchases]
drive down a broad range of longer-term borrowing rates. And lower rates get households and
businesses to spend more than they otherwise would, boosting economic activity." 241

But QE in the U.S. also affected other countries. As John Williams has acknowledged, “although
it’s not our main intention, these unconventional policies have also had an effect on the dollar
versus foreign currencies. When interest rates in the U.S. fall relative to rates in other countries,
the dollar tends to decline as money flows to foreign markets with higher returns. One estimate is
that a $600 billion program like QE2 causes the dollar to fall by roughly 3 or 4% . . . . That helps
stimulate the U.S. economy by making American goods more competitive at home and
abroad.” 242

Again, take China as an example. “As the Fed printed more money in its QE programs, much of
that money found its way to China in the form of trade surpluses or hot money inflows looking
for higher profits than were available in the United States.” 243 QE put more dollars into
circulation, hence diluting the value of the dollar. Because the dollar is the world’s reserve
currency, many products, particularly commodities, are priced in dollars. Therefore, when the
dollar depreciates, the price of commodities appreciates. This affects many countries such as
China because the Chinese economy is heavily dependent on purchasing raw materials and using
them to make products for exports. China’s trade minister, Chen Deming, said, “Uncontrolled
printing of dollars and rising international prices for commodities are causing an imported
inflationary 'shock' for China and are a key factor behind increasing uncertainty.” 244

In the end, the U.S. got what exactly it wanted: if China refused to revalue the yuan, it would get
American-exported inflation instead. 245 Both Chinese revaluation of the yuan and American-
exported inflation would serve U.S. interests because both increased the costs of Chinese

241 John C. Williams , The Federal Reserve’s Unconventional Policies, FRBSF ECONOMIC LETTER, November 13,
reserve-unconventional-policies/

242 Id.

243 RICKARDS , supra note 51, at 135.

http://money.usnews.com/money/business-economy/articles/2010/10/29/why-china-has-a-point-about-quantitative-
easing

245 For the U.S., however, inflation is contained because the U.S. gets cheap imports from trade. RICKARDS, supra
note 28, at 75.
exports, which in turn made American exports more competitive. In many ways, for China, inflation induced by QE is worse than revaluation. China could control revaluation, choosing when to revalue. But inflation would be harder to control – it “could have huge behavioral impacts and start to feed on itself in a self-fulfilling cycle as merchants and wholesalers raised prices in anticipation of price increases by others.”

As proof of QE success for the U.S. economy, Bernanke pointed to the 25% increase in U.S. equity prices, which began from the beginning of QE2 in August, 2010, to the end of February, 2011. For the U.S., this was a good development – “the Fed intended for the ‘excess’ liquidity to push up asset prices, probably hoping that the “wealth effect” of higher asset prices would spur economic activity in the U.S.”

But for other countries, “the impact of QE on commodities and the food and energy inflation that it may have inadvertently, or perhaps purposefully, engendered” have created havoc. Thus, when the Fed lowered interest rate to zero and pursued QE, its action had cross-border effects not just because more dollars flooding the market devalues the dollars, causing energy and commodities that are often priced in dollars to cost more (because it requires more dollars to buy them). Rather, inflation can also occur when large capital inflow fuels those economies, driving up demand for resources or further spurring speculation in commodities, increasing demand and prices.

Moreover, U.S. interest rate at zero means that U.S. investors seek higher returns elsewhere – in emerging markets – and in the process drive up the value of many of the currencies even as QE drives down the value of the dollar. In 2010 the Brazilian Finance Minister, Guido Mantega, called this combustible situation of commodity inflation a “currency war” unleashed by U.S. QE. Indeed, “Brazil was stuck between the rock of currency appreciation and the hard place of inflation.”

Emerging countries have few options. Like China, they can peg their currency to the dollar,

246 RICKARDS, supra note 51, at 135-36.

247 Id. at 136.


249 Id.

250 Id.

251 Id.

252 RICKARDS, supra note 51, at 123.
protecting their export markets but suffering inflation in the process. The PBOC’s money printing to maintain the yuan-dollar peg quickly led to increased prices there with China importing inflation from the U.S. (as opposed to having exported its deflation to the U.S. previously). 253 Inflation can have serious consequences in emerging economies. Indeed, it was one of the catalysts of the 1989 Tiananmen Square protests. Trade surpluses and hot money in search of higher yields meant dollar inflows into many emerging economies, causing disruption in South Korea, Brazil, Indonesia, Thailand, Vietnam and elsewhere. 254

Although the Fed has denied that its actions, particularly QE2, are a driver of protests and revolutions abroad and admittedly, commodity prices are influenced by a multiplicity of factors (desertification or drought, for example), commentators have connected the dots between the prices of food and purchase of U.S. Treasuries by the Fed. 255 Data showed that “the food price index broadly stabilised through late 2009 and early 2010, then rose again from mid-2010 as quantitative easing was re-started (QE2) . . . with prices rising of about 40% over an eight month period.” 256 As in Tiananmen Square, a rapid rise in food prices also contributed to disturbance and revolution in the Middle East. 257 The Middle East and North Africa, more than other regions, heavily depend on imported food; in Egypt, for example, local food prices rose 37%. 258 In Jordan and Syria, food prices rose 59 percent. 259 “When a peasant lives on $3,000 per year, rising food prices are the difference between eating and starving, between life and death. The civil unrest, riots and insurrection that erupted in Tunisia in early 2011 and quickly spread to Egypt, Jordan, Yemen, Morocco, Libya and beyond were as much a reaction to rising food and energy prices and lower standards of living as they were to dictatorships and lack of democracy.” 256 It is thus not surprising that Mohamad Bouazizi, the Tunisian whose self-

253 Id. at 135.

254 Id. at 137.


256 Id.

257 Id.


260 RICKARDS, supra note 51, at 138. Zurayk, supra note 258.
immolation triggered the Arab Spring protests, was a food vendor. Hence even as China hangs on to its export model and its purposely devalued yuan, and even as the U.S. continues to “inflate away China’s export cost advantage,” inflation could not be confined “only” to China.

To put China’s dollar holdings into historical perspective, if the Bretton Woods system were still anchored to gold, one could safely assume that China would have opted to cash in some of its Treasury securities for U.S. gold held in reserves. A redemption of $100 billion of Treasury notes at the 2008 gold price of $1000 per ounce would have equaled 35 percent of the entire official gold supply of the U.S.; and a full redemption of all U.S. government securities held by China would have wiped out all of the U.S. gold supply. The question is how China can protect its own dollar holdings and still diversify from its dollar-based assets. When “the U.S. government announced a $1.5 billion budget deficit and the Federal Reserve decided to buy hundreds of billions of government and agency debt” in 2009, China quickly questioned the continued use of the dollar as an international reserve currency.

Some have warned about the looming currency wars. After the 2008 financial crisis and the “unprecedented explosion of financial credit,” concern about the prevalence of paper money became even more pronounced. “[P]aper currencies, not backed by any commodity standard, had facilitated unprecedented credit expansion.” And as some have observed, “paradoxically, the paper which had been responsible in large part for the explosive increase in credit was now seen to provide the solution.”

At present, dangerous fault lines exist beneath the dollar-based international economic system. Part B connects the dots, so to speak, to highlight seemingly disconnected events which demonstrate dissatisfaction with the way the U.S. handles the dollar. It also examines actions being pursued by China and other countries to chip away at dollar dominance and to create

261 RICKARDS, supra note 51, at 138.

262 Id. at 107-108.

263 Ferguson & Schularick, supra note 221, at 24.


265 KWARTENG, supra note 23 at 319. Of course there were other commentators who had warned about “reckless credit expansion” before the 2008 crisis. Peter Warburton, Debt and Delusion: Central Bank Follies that Threaten Economic Disaster 11 (2000), cited in id.

266 KWARTENG, supra note 23 at 426.

267 Id. at 342.
alternatives to the status quo.

**PART B. NEW NON-DOLLAR BASED SYSTEMS**

This Part examines three main developments that signal not just global disillusionment with the dollar generally but concrete actions to create alternatives to the dollar-based system particularly. Some are a particular reaction to U.S. initiated currency wars and others reflect a general disillusionment with the dollar: 1) the historic 2014 multi-billion dollar gas deal between Russia and China which should be seen as one of many efforts to diminish the dollar’s role in oil and gas pricing, that is, to eradicate the dollar’s privilege as a currency backed by oil; 2) the establishment of a development bank by BRICS to challenge the Western dominated World Bank and IMF; 3) the search for commodities of intrinsic value such as gold to challenge fiat money such as the dollar.

First, as noted in the Introduction, the U.S. itself has unleashed financial warfare against Iran and its currency, the rial. The U.S. severed Iran from the international banking and payments system, barring Iran from receiving dollars for oil exports and sending dollars out to pay for needed imports. Iranian merchants faced with dollar shortage turned to the black market, exchanging rials for dollars at astronomically depressed rates. Depositors rushed to withdraw their rials to purchase hard assets and dollars or other hard currencies. To prevent a bank run, the government had little choice but to raise interest rates to induce depositors to keep their money in the banks. One of Iran’s largest crude oil buyers, India, capitulated to U.S. pressure and shut down its primary financing facility used to pay for Iranian oil. 268

Iran has turned to China for financing help with ambitious projects and for trade when faced with Western sanctions. Iran and China have started on building a new Silk Road and China is now Iran’s largest trading partner. 269 Iran also sells its oil to China, taking care to avoid violating American banking laws by using Russian and Chinese banks and by bartering. 270 It entered into an oil-for-gold swap with India, whereby India would buy gold and swap it with Iran for oil. Iran would in turn swap the gold with Russia or China for food and other goods.

Iran is also selling crude oil to China, taking yuan as payment. 271 It has also pursued a gold


strategy, expanding its gold trading with Afghanistan, the UAE, and Turkey.\textsuperscript{272} To keep the U.S. from freezing its dollar balances, it dumped dollars and bought gold. In July, 2013, to deal with Iranian circumvention of American banking sanctions, the U.S. banned gold sales to Iran; gold traders in other countries who flouted this regulation would risk American penalties, including expulsion from the U.S. precious metals market.\textsuperscript{273}

Any movement away from the oil for dollar system – either by using gold or a non-dollar currency – will be a serious threat to dollar hegemony. Dissatisfaction with dollarization of the international oil market has been bubbling for many years. For example, before the U.S. invasion of Iraq, Saddam Hussein made the switch from the dollar to the euro for oil trading, in a move intended as both retribution for U.S. sanctions and as encouragement of Europeans to challenge such sanctions.\textsuperscript{274} Representative Ron Paul asserted a controversial and scantily noticed link between the invasion of Iraq and Hussein’s rejection of the dollar: “Saddam Hussein demanded Euros for his oil. His arrogance was a threat to the dollar; his lack of any military might was never a threat…. I doubt it was the only reason, but it may well have played a significant role in our motivation to wage war.”\textsuperscript{275} Others have asserted a similar link between the ouster of Gaddafi and his plan to refuse the dollar as payment for oil, insisting instead on a new currency, the gold dinar. “Gaddafi suggested establishing a united African continent, with its 200 million people using this single currency. During the past year, the idea was approved by many Arab countries and most African countries.”\textsuperscript{276}

In a little noticed 2002 speech to OPEC, Javad Yarjani, a senior Iranian oil diplomat, floated the possibility that oil could be priced in euros.\textsuperscript{277} Since then it is establishing an oil bourse that will trade oil in currencies other than the dollar.\textsuperscript{278} The former U.S. Ambassador to Saudi Arabia,
Chas Freeman, testified before a congressional committee that “One of the major things the Saudis have historically done, in part out of friendship with the U.S., is to insist that oil continues to be priced in dollars. Therefore, the US Treasury can print money and buy oil, which is an advantage no other country has. With the emergence of other currencies and with strains in the relationship, I wonder whether there will not again be, as there have been in the past, people in Saudi Arabia who raise the question of why they should be so kind to the United States.”

The dollar faces serious threats from rivals. “Whether in yuan or roubles, non-dollar trading – which enables countries to bypass U.S. claims to legal jurisdiction – will transform the prospects facing Iran and Syria, particularly in the field of energy reserves, and deeply affect Iraq which is situated between the two.” As Russia faced sanctions over its actions in Crimea and Ukraine, President Putin of Russia announced in August 2014 that Russia will aim to sell its oil and gas for rubles globally to bypass dollar monopoly in energy trade. “We should act carefully. At the moment we are trying to agree with some countries to trade in national currencies,” Putin said during his visit to Crimea, annexed from Ukraine in 2014.

There are reports of secret meetings being held among ministers and central bank governors in Russia, China, Japan and Brazil to work on a new arrangement in which oil will no longer be priced in dollars but instead will be tied to a basket of currencies, including the Japanese yen and Chinese yuan, the euro, gold and a new, unified currency planned for nations in the Gulf Cooperation Council, including Saudi Arabia, Abu Dhabi, Kuwait and Qatar. In the meantime, according to Chinese banking sources, the transitional currency in the move away from dollars is likely to be gold.

Interestingly, analysts in the oil and gas industry find diversification away from petrodollars to


281 Putin says Russia should aim to sell energy in roubles, Reuters, August 14, 2014.


283 Id.
be a natural development given the reality of trade. One reason might simply be that many countries such as China, Russia and those in the Middle East already have large dollar holdings and wish to diversify into other currencies. Moreover, as bilateral trade between China and other countries grows, or as China and Russia trade oil, “why would they want to do that solely in dollars?”. And indeed, movements are underway between China and Russia to carve an alternative natural-resource universe denominated in a non-dollar currency, most likely the yuan. The newest linkage between China and Russia – barely two months after Russia’s annexation of Crimea in March 2014, is an historic $400 billion gas agreement for the construction of a pipeline and the transportation of natural gas from Russia to Western China over the next several decades.

The cost of construction and processing facilities is estimated at $70 billion, although it will be partially offset by a multi-billion loan from China in exchange for a discount in the purchase price. China is “the largest energy consumer and producer in the world. Rapidly increasing energy demand, especially for petroleum and other liquids, has made China influential in world energy markets.” The gas deal cements “the two partners as a counterhegemonic bloc to the West.”

Analysts “predict that the oil exports would mean Chinese yuan being exchanged directly, into the Russian ruble. Thus the two countries would bypass the U.S. dollar - the traditional currency used in oil trades and considered to be the international reserve currency of choice.” Russia’s willingness to accept yuan as payment for its oil has made it the number one oil supplier for China. Although as noted, China’s stock market and currency fluctuated wildly in early

---


285 Id.


287 Id. at 261-62.


289 Biersack & O’Lear, supra note 286, at 262.

290 Clinch, supra note 68.


292 See supra note .
2016, it would be wrong to see the yuan as a weakened currency. It has been included in the SDR basket as a global reserve. Thus, the yuan will be more international and its value will appreciate as central banks increase their yuan holdings, following signals by the central banks of Korea, Philippines and Indonesia that they plan to increase their own yuan reserves. As early as 2010, Nigeria, anticipating greater yuan internationalization, announced that it would put a tenth of its reserves, or $ billion, into yuan. This past December 2015, Zimbabwe announced it would make the yuan the official legal tender of the country.

Russian willingness to accept the yuan has been further reinforced by Western sanctions against Russia for its conduct in the Ukraine and Crimea. Although Western sanctions explicitly permitted the use of the dollars and euros as payment for Russian oil and gas, “the sanctions triggered alarm among Russian executives, who viewed the measures as a sign that the west was willing to use currency as a weapon.” Consequently, Russian officials and executives have begun the shift from the U.S. dollar to the yuan as part of the Kremlin’s “pivot to Asia.”

---


295 Bradsher, *infra* note 76. See also Emefiele, *infra* note 293.

296 Zimbabwe to Make Chinese Yuan Legal Currency After Beijing Cancels Debts, THE GUARDIAN, Dec. 21, 2015, at


Gazprom Neft, Russia’s third largest oil producer and the oil arm of the state-owned Russian gas company Gazprom, announced that since the beginning of 2015, it had been selling its oil to China for yuan.\textsuperscript{299}

Russian and Chinese monetary linkages have grown in other areas as well. For example, VTB, Russia’s second biggest bank, entered into an agreement with the Bank of China to pay each other in their respective domestic currencies.\textsuperscript{300} The two countries have also announced that in bilateral trades, they will no longer use the U.S. dollar but will use their respective domestic currencies instead.\textsuperscript{301} Trade between Russia and China is already nearly $90 billion, and it is expected that using more local currencies will speed up trade, which is scheduled to reach $200 billion in the next six years.\textsuperscript{302} Cooperation between Russian and Chinese banks is also increasing, as China’s state-owned Import Export Bank, has agreed to help Russian banks cut off from Western capital markets as a result of Western sanctions.\textsuperscript{303}

Although there have been other attempts to isolate the dollar – for example, agreements between China and India and China and Brazil\textsuperscript{304} and China-Russia yuan-ruble swaps,\textsuperscript{305} the gas deal is in a different league altogether. Because the deal is so huge, involves the world’s largest energy importer, China, and the world’s largest energy producer, Russia, it “threatens the global petro-currency status of the U.S. dollar. . . . In other words, the growing importance of Russia and China in the global energy picture – and their phasing out of dollar usage for trading energy

\begin{itemize}
  \item Id.
  \item Clinch, supra note 68.
  \item Id.
  \item Halligan, supra note 10.; Agnieszka Flak and Marina Lopes, Emerging Powers China, Brazil Make Plans to Bypass U.S. Dollar, \textit{THE GLOBE AND MAIL}, March 26, 2013, available at \url{http://www.theglobeandmail.com/report-on-business/international-business/african-and-mideast-business/emerging-powers-china-brazil-make-plans-to-bypass-us-dollar/article10368191/}. China and Brazil agreed to swap up to $30-billion in each other’s currencies if needed so bilateral trade would not suffer if there is turbulence in the global financial market dominated by the dollar.
  \item Ruble Swap Shows China Challenging IMF as Emergency Lender, Bloomberg News, December 22, 2014, available at \url{http://www.bloomberg.com/news/articles/2014-12-22/yuan-ruble-swap-shows-china-challenging-imf-as-emergency-lender}. In October 2014, China and Russia signed a three-year currency-swap line of 150 billion yuan ($24 billion), allowing Russia to borrow yuan and lend the ruble, which lost 41 percent due to plunging oil prices and Western sanctions linked to Russian annexation of Crimea.
\end{itemize}
commodities – would marginalize the status of the dollar” and threaten its unique status. The U.S. Treasury market would be weakened, which would in turn make it difficult for the U.S. to continue financing its chronic dollar-denominated debt of more than $17.5 trillion.

Consequently, what we now have is “[a] profound transformation of the global monetary system . . . driven by a perfect storm: the need for Russia and Iran to escape Western sanctions, the low interest rate policy of the U.S. Federal Reserve to keep the American economy afloat and the increasing demand for Middle East oil by China.” As discussed later, hoarding gold is thus becoming not just an investment strategy but also a financial weapon.

The China-Russia gas deal should also be viewed in a yet broader context – the establishment of not just different reserve currencies to challenge the dollar but also of an alternative system to challenge Bretton Woods. In 2014, exactly seventy years after the Bretton Woods summit, the governments of Brazil, Russia, India and China held a conference in Fortaleza, Brazil to mark the establishment of a development bank that, “whatever diplomatic niceties are put on it, is intent on competing with the IMF and World Bank.”

There are many reasons why the NDB was erected. BRICS, especially China, has pushed for voting reform at the IMF to no avail, arguing that voting powers are skewed in favor of Western Europe even though economic conditions, as measured by population growth, foreign currency reserves, and economic output, have changed significantly since the founding of the IMF. As Joseph Stiglitz explained, the NDB fills a need. It provides additional investment in trillions

---

307 Halligan, supra note 10.
308 Crooke, supra note 280.
309 See infra
310 RICKARDS, supra note 28, at 58.
of dollars per year; and second, because it reflects the increasing power of BRICS, it corrects the
democratic deficit currently of the IMF and the World Bank.\footnote{Id.} Regardless, BRICS was also established to challenge the dollar-based system, or as
euphemistically put, to “support the reform and improvement of the international monetary
system, with a broad-based international reserve currency system providing stability and
certainty. We welcome the discussion about the role of the SDR in the existing international
monetary system including the composition of the SDR’s basket of currencies.”\footnote{RICKARDS, supra note 28, at 149.} As Russian
Prime Minister Dimitri Medvedev said in 2014, the efficacy of the Bretton Woods system had to
be questioned after the 2008 financial crisis.\footnote{Interview with Russian Prime Minister Dmitry Medvedev, CNBC, Oct. 15, 2014, available at
http://www.cnbc.com/2014/10/15/cnbc-exclusive-transcript-russian-prime-minister-dmitry-medvedev-speaks-with-cnbc-geoff-cutmore-today.html} “This is when we started wondering whether the
Bretton Woods system was enough, whether one powerful currency - the US dollar - and several
reserve currencies such as the euro, the pound and others can support the entire global financial
system.”\footnote{Id.}

With China and Russia renouncing the dollar in their bilateral trade\footnote{Su Qiang and Li Xiaokun China, Russia quit dollar, CHINA DAILY, Nov. 24, 2010, available at
http://www.chinadaily.com.cn/china/2010-11/24/content_11599087.htm.} and leading the charge,
the BRICS countries, which collectively hold over 50 percent of global currency, established a
$100 billion development bank as a “first concrete step toward reshaping the Western-dominated
international financial system.”\footnote{Gruzalski, supra note 275.} BRICS leaders also signed another agreement setting up a
Contingent Reserve Arrangement (CRA) which is a reserve currency pool with $100bn in initial
billion, with each BRICS country contributing $10 billion. The initial capital contribution of
each participant to the CRA will reflect each country’s stake in global GDP\footnote{Jordan Totten, BRICS New Development Bank Threatens Hegemony of U.S. Dollars, FORBES, (December, 22,
capital, or reserves, are planned to be denominated in each country’s currency. The NDB, will finance infrastructure and sustainable development projects (like the World Bank), and the CRA, will provide assistance to members in financial difficulty (like the IMF).

Countries can also minimize dependency on the dollar-based system – protecting themselves from sanctions and asset freezes – “by converting paper wealth to gold,” an option China and a few others have been pursuing aggressively. China and India, Iran and Russia, among others, have used their monetary reserves to increase their gold positions. Gold plays an important role in China’s quest to internationalize the yuan and position it as a preeminent reserve currency. One way to accomplish this is to have it included in the IMF’s SDR basket, which China achieved in November 2015 when the IMF deemed it a major exporter with a “freely useable currency” increasingly driven by market forces.

Another step China has taken to acquire elite status for its currency and to challenge dollar dominance in trade involves the acquisition of gold. Gold still functions as a credible alternative and hence challenge to the dollar’s elite status. Even though gold is no longer used to back paper money, central banks still hold gold as part of their bank reserves, with the IMF alone holding 2814 tons. Since 2010 when China became the world’s second largest economy, the government has “stepped up efforts to make the yuan a viable competitor to the dollar. That’s led to speculation the government has stockpiled gold as part of a plan to diversify $3.7 trillion in foreign-exchange reserves.”

In July 2015, China reversed years of secrecy and reported that it has purchased 604 tons of gold

321 Id.
322 Previous BRICS Summits, supra note 319.
323 RICKARDS, supra note 28, at 61.
327 Id.
since 2009, an amount second only to Russia.\textsuperscript{328} With this purchase representing a 60 percent increase in its reserves since 2009,\textsuperscript{329} China displaced Russia as the world’s fifth-largest holder of gold.\textsuperscript{330} “The purchases show how China is seeking to diversify its reserves away from the US dollar at a time when the price of gold has fallen to near its lowest price since 2010.”\textsuperscript{331}

Unlike other big gold holders such as Germany and Russia which update gold holdings monthly,\textsuperscript{332} China does not regularly disclose data on its gold reserves.\textsuperscript{333} The PBOC’s report of its addition of slightly more 600 tons of gold showed up, surprisingly, (or perhaps not) as one single entry in June 2015.\textsuperscript{334} Such a huge purchase is difficult to accomplish in one transaction unless it is prearranged between central banks or the IMF; as there was no record of such arrangement, “[t]he conclusion is inescapable that China is actually accumulating gold in smaller quantities over long periods of time, and reporting the changes in a lump sum on an irregular basis.”\textsuperscript{335}

The Chinese decision to reveal its gold holdings in 2015 might have been timed to showcase openness and transparency, a gesture meant to impress the IMF as it considered including the


\textsuperscript{329} \textit{China Breaks Silence on Gold Reserves}, FINANCIAL TIMES, July 18, 2015, available at \url{http://www.cnbc.com/2015/07/18/china-breaks-silence-on-gold-reserves.html}


\textsuperscript{331} \textit{China Breaks Silence on Gold Reserves}, supra note 329. “The new data shows the country is using the metal to diversify foreign-exchange reserves as policy makers push for the yuan to be added to the International Monetary Fund’s basket of currencies.” \textit{China’s Been Hoarding Gold And It Isn’t Likely to Stop}, supra note 328.

\textsuperscript{332} \textit{China Breaks Silence on Gold Reserves}, supra note 329.

\textsuperscript{333} In 2015, China started reporting its reserves under the IMF’s Special Data Dissemination Standards, a method launched in 1996 and used by more than 70 countries, mostly developed economies, to provide monthly reports of gold holdings in value and volume. Henry Sanderson, \textit{China Reveals Increase in Gold Holdings}, FINANCIAL TIMES, Aug. 14, 2015, available at \url{http://www.ft.com/intl/cms/s/0/942ac8ee-4260-11e5-b98b-87c7270955cf.html#axzz3nptUuxyq}


\textsuperscript{335} \textit{RICKARDS, supra note 28, at 227.}
yuan in the SDR. In addition, by adding a lot of gold to its reserves and disclosing the latest numbers, China demonstrated that its currency is supported by hard assets in amounts sufficiently large for it to be deemed a big player.

However, commentators doubt the accuracy of these numbers because information about the country’s gold holding is considered a state secret in China, and because of the PBOC’s history of false reporting. But China’s covert accumulation may also make financial sense because any large buyer may wish to disguise its intention to minimize market impact and price hike. Moreover, China may not wish to trigger a loss of confidence in dollars, due to its continuing substantial dollar holdings. Thus, Chinese purchases are done through “secret agents and direct purchases from mines,” many located in China and others in southern Africa and western Australia. By 2007, China surpassed South Africa as the world’s largest gold producer, mining 437 tonnes in 2013 alone. To cast one-kilo gold bullions, gold ore from Chinese-owned mines, in and outside of China, is transported to refineries in China, Australia, South Africa and Switzerland and then shipped to vaults in Shanghai, thus bypassing the London market, minimizing market impact and keeping the exact amount of gold China actually has a secret.

China is also the world’s largest consumer of gold and as well, the largest importer of gold.

---

336 China Breaks Silence on Gold Reserves, supra note 329.

337 The Mystery of China’s Gold Stash May Soon Be Solved, supra note 326.

338 As Beijing reveals modest gold hoard, bulls cry more, more, more, REUTERS, July 20, 2015, available at http://mobile.reuters.com/article/BigStory11/idUSKCN0PU0V220150720

339 Chang, supra note 330.


341 RICKARDS, supra note 28, at 227.

342 Id. at 228.


344 RICKARDS, supra note 28, at 228.

Reports indicate that China has increased gold imports since 2009, so that from 2010 to May 2015, Chinese gold imports through Hong Kong were well over 3,300 tons. Moreover, it also has gold imports through Shanghai, but this amount is undisclosed. Investors have noted that “[w]hile gold imports from Hong Kong provide a directional sense of China’s demand, they offer incomplete data because additional shipments come into China through Shanghai and Beijing as well.” Some estimate that China actually possesses as much as 3,510 metric tons, suggesting that China could be underreporting its gold holdings by 1,850 tons.

If numbers from China’s own gold mining production and imports, whether through Hong Kong or Shanghai, are not reflected in PBOC disclosures, where is the gold? The private sector. China has outpaced India with private sector gold purchases accounting for 26 percent of the world’s total gold purchases in 2013. The World Gold Council, the market development organization for the gold industry, reported that by encouraging “‘domestic absorption of gold’” by the private sector . . . [,] these ‘reserves’ held by the population could always be called upon by the state, and subject to Chinese state control.

Chinese gold can also be held in a myriad of other state owned banks other than the PBOC, such as the Agricultural Bank of China, Bank of China, the China Investment Corporation, a sovereign wealth fund responsible for managing the country’s foreign exchange reserves, and/or the State Administration of Foreign Exchange, and these holdings would not need to be reported as part of official central bank reserves. Whenever the government wishes to report a higher figure, it can do so by moving the gold into the PBOC.

---

346 Cammarosano, supra note 334.

347 Id.


349 Chang, supra note 330; Jean Chen, supra note 345.


351 Id.

352 Cammarosano, supra note 334.

The continuing importance of gold in the face of uncertainty is further corroborated by the growing number of countries seeking to repatriate their gold. In May 2015, Austria’s central bank announced plans to repatriate £3.5bn of its gold reserves currently stored in Britain, constituting 80% of its entire stocks after auditors warned against storing gold in a foreign country.\footnote{Phillip Inman, Austria’s Central Bank to Repatriate 3.5 bn of Gold Reserves from UK, THE GUARDIAN, May 28, 2015, available at \url{http://www.theguardian.com/business/2015/may/29/austrias-central-bank-to-repatriate-35bn-of-gold-reserves-in-uk}} The Austrian National Bank will spend the next five years flying gold bullions from London to Vienna, a move reminiscent of Germany’s plan in 2013 to repatriate 300 tons of its gold stored in New York to ensure at least 50 percent was safe in Germany by 2020.\footnote{Clinch, supra note 68; Inman, supra note 354.}

In November 2014, the Dutch central bank announced that it had repatriated 122.5 tons of gold from New York to Amsterdam, claiming the move should “‘have a positive effect on public confidence.’”\footnote{Vernon Silver, Where is Germany’s Gold, BLOOMBERG BUSINESS, Feb. 5, 2015, available at \url{http://www.bloomberg.com/news/features/2015-02-05/germany-s-gold-repatriation-activist-peter-boehringer-gets-results}} Belgium too has initiated gold repatriation,\footnote{Now Belgium Seeks Repatriation of Its Gold, Dec. 6, 2014, ronpaulforums.com, available at \url{http://www.ronpaulforums.com/showthread.php?464368-Now-Belgium-Seeks-Repatriation-of-its-Gold}} and a similar call to audit and repatriate French gold back to France is also taking place.\footnote{Swiss, French Call to Bring Home Gold Reserves as Dutch Move 122 Tons Out of US, RT, Nov. 27, 2014, available at \url{https://www.rt.com/business/209591-gold-europe-gold-repatriation/}; Alan Feuer, The Golden Age, N.Y. TIMES, Dec. 6, 2014, available at \url{http://mobile.nytimes.com/2014/12/07/sunday-review/the-golden-age.html}} The rush to repatriate is in sharp contrast to the post-World War II and Cold War days when European countries stored their gold as far from the Communist bloc as possible in case of a Soviet invasion. Despite the fall of the Iron Curtain, much of European gold is has been kept in financial centers like New York and London, as “[i]t remains the one currency that is accepted everywhere. In the event of a currency crisis, the gold could be quickly deployed in financial markets to help restore confidence.”\footnote{Jack Ewing, Germany to Move 674 Tons of Gold, N.Y. TIMES, Jan. 16, 2013, available at \url{http://mobile.nytimes.com/2013/01/17/business/global/german-central-bank-to-repatriate-gold-reserves.html?_r=0}} New York especially has been a favorite because The New York Fed stores gold without charge because the “presence of foreign gold supports the dollar’s status as the global reserve currency.”\footnote{Id.}

Interestingly, the movement to take gold back for safekeeping is led by Northern European...
countries that form the core of the “haves” within the EU. Again, one returns to the trust issue – that is, “building trust with citizens frustrated by years of easy-money policies.” Analysts have offered different reasons for this trend. Some explain the repatriation frenzy as “an indication that financial Armageddon, in the guise of runaway inflation, is approaching.” Others view it “as a symbolic way for central banks and governments to make a show of strength in nervously uncertain economic times.” The continuing financial crisis has heightened anxieties in many countries about fiat money and “the safety of their gold reserves abroad.” Moreover, the financial crisis “marks a deeper anxiety amongst tax payers and savers for the monetary system to have a more solid base than QE (quantitative easing) and zero rates . . . “ Gold remains “a highly liquid asset that is easily exchanged for other currencies.” The repatriation “is especially pronounced in Europe, where central banks face public pressure to buy more gold or bring back home what they hold in vaults overseas.”

Additionally, given the financial crisis facing Greece and other European countries, the notion that the EU is splittable is not far-fetched. Southern European countries such as Greece, Spain, Portugal, Italy, and Cyprus are mired in a recession that has required bailouts by the euro area’s northern countries, leading to prediction that the euro system will be dismantled.

361 The EU is located in Brussels and the European Central Bank in Frankfurt.


364 *Id.*

365 *Swiss, French Call to Bring Home Gold Reserves as Dutch Move 122 Tons Out of US, supra* note 358.


368 Blackstone & Silsenrath, * supra* note 362.


Economic distress has brought into stark contrast the economic disparity and cultural differences between the poorer periphery euro zone countries and the richer core euro zone ones.371 “For the great many Germans who still rue the day they had to trade their marks for euros, there has been at least one consolation. If the common currency did not work out, Germany still had huge reserves of the hardest currency of all: gold.”372

Moreover, the so-called Nordic bloc of countries – Germany, Belgium, Austria, and the Netherlands have not only the highest rated credits but also a combined gold reserve of 4000 tons. “These four countries with reserves of 4,000 tons will have the ability to set up a northern or “Nordic euro” … especially if China revalues gold and resets the world’s financial system . . . .”373 Thus, the discovery by Germans that their gold was not physically in their own country resulted, as discussed, in calls to repatriate it back to Germany – even as the Bundesbank vociferously denied that repatriation reflected any lack of trust in the New York Fed.374 Nonetheless, the fact remains that “[t]he system, of course, is built upon trust – that the New York Fed won’t suddenly be taken over by people with no respect for [other] nations’ property rights and seize it for their own use, and that the central banks won’t lie about how much gold is in their vaults.”375

Even if some economic experts do not see “pending doom in the repatriation schemes and the shopping sprees by Moscow and Beijing,”376 those actions are still highly significant because they trumpet “a desire to challenge a rival. . . .”377 and in the case of the Chinese and the Russians, to broadcast the fact “that they’re unhappy with the dollar or that they want to become a global player . . . .”378

**CONCLUSION**


372 Ewing, supra note 359.

373 Holter, supra note 369.

374 Ewing, note 359.


376 Ewing, supra note 359.

377 Feuer, supra note 363.

378 Id.
The dollar’s exorbitant privilege is being challenged by allies and rivals alike. Like his predecessor Charles De Gaulle, who was resentful of the dollar’s unique status, French President Nicolas Sarkozy proclaimed in the midst of the 2008 financial crisis that “We need a new Bretton Woods. We can’t have on the one hand a multipolar world and on the other a single reserve currency on a global level.” As noted, China has called for a reserve currency that is not issued by any one country. Russia too has denounced the continued use of the dollar as a reserve currency issued, ironically, by a debtor (albeit hegemonic) country: “one center of consumption, which is financed by deficit, and correspondingly, an accumulation of debt, one reserve currency that is powerful as never before, and one predominating system of evaluating risks and assets.”

A few scholarly commentators have issued warnings about the likely consequences of dollar decline from singular currency to one among many, or from top currency to “negotiated” currency. “The relative diminution of the dollar as an international currency to something like first-among-equals status will not only cause the United States to lose privileges it once enjoyed—its coercive power enhanced by greater autonomy and its structural power implicitly shaping the preferences of others—but it will also produce new burdens, which Americans will be singularly unaccustomed to bearing.”

The ripple effect will likely be felt in myriad ways in different areas of U.S. interests, including economic, political and security interests. The following observation accurately reflects what I have described throughout the article: “[A] shift away from the dollar as a reserve currency and pricing standard for oil transactions, could be catastrophic for the United States. In the worst case scenario, a drastic drop in demand for dollar-denominated assets would cause the interest rates on Treasury Securities to skyrocket, sending ripples through the US economy as the value of the dollar plummets. . . . [The] . . . decrease in demand for US debt . . . will constrain the federal government's ability to spend and the ability of the United States to defend itself. The United

---


380 See supra note 40.

381 Andrew Batson, China Takes Aim at Dollar, WALL ST. J. (Mar. 24, 2009), http://online.wsj.com/articles/SB123780272456212885. “Because other nations continued to park their money in U.S. dollars, the argument goes, the Federal Reserve was able to pursue an irresponsible policy in recent years, keeping interest rates too low for too long and thereby helping to inflate a bubble in the housing market.”


384 JONATHAN KIRSHNER, AMERICAN POWER AFTER THE FINANCIAL CRISIS 144 (2014).
States has built its foreign policy around its vast military capability; a sudden budgetary shock and drop in military spending would leave the United States vulnerable as it scrambles to regroup in a new security environment.”

This Article has traced the evolution of the dollar and shown how it evolved from its origin in coins of gold and silver to paper “greenbacks” backed by gold to its current state – fiat money unbacked by anything of intrinsic value and issued by a debtor, albeit powerful, country. As late as the 1980s, the United States was “the world’s largest creditor and source of investment money” but “[b]y 2000, America’s net foreign liabilities had become larger than those of all other debtor countries combined . . . .” In its current incarnation, the dollar is most vulnerable to challenge – internal because of chronic deficits and external because of international rivalries and intense dissatisfaction with how the U.S. has managed the dollar and the effect this has created on the rest of the world. Indeed, the IMF itself issued a report warning that the staggering increase in U.S. foreign debt is a hazard to the global economy and “could play havoc with the value of the dollar and international exchange rates.”

The dollar may be strong this year or weak last year. That is the nature of a market-based floating system. But regardless of any momentary snapshot, various indicators show that an alternative, non-dollar system is being slowly but surely created. The Triffin Dilemma, combined with the global economic crisis of 2008, has triggered heated debate about the international monetary system, and because the dollar is at the centerpiece of this system, about the dollar itself. Different proposals have been put forth by governments, quasi-governmental bodies, government officials and others to correct imbalances specifically in the dollar-based international economic system and more generally in the international economic legal


387 Id.


389 See supra notes 169-170 and accompanying text.

390 See e.g, Zhou, supra note 40 (favoring first a super-sovereign reserve currency but proposing as a second-best, a greater role for the IMF’s SDR because it has “the features and potential to act as a super-sovereign reserve currency.”); U.N. Conference on the World Financial and Economic Crisis and its Impact on Development, June 24-26, 2009, Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System, at 98, 117 (rejecting a multi-currency reserve system and supporting a “truly global reserve currency” in which countries agree to exchange their own currencies for a new currency called “International Currency Certificates” which cannot be held in excessive quantities to facilitate adjustment between deficit and surplus countries); Bennhold, supra note 379 (Sarkozy calling for a single reserve currency untied to any one country); McKinsey Global Institute, An Exorbitant Privilege? Implications of Reserve
framework itself. This Article has not focused on the many theoretical or policy proposals that have sprouted post-2008 because its emphasis is on concrete developments and concerted actions that have already been undertaken to undermine dollar hegemony.

“The endgame to Triffin’s paradox is a global, wholesale dumping of the center country's securities. No one knows in advance when the tipping point will be reached, but the damage brought about by higher interest rates and slower economic growth will be readily apparent afterward.” At the height of the 2008 financial crisis, Luo Ping, a director-general at the China Banking Regulatory Commission, agonized thus: “Except for U.S. Treasuries, what can you hold? Gold? You don't hold Japanese government bonds or UK bonds. U.S. Treasuries are the safe haven. For everyone, including China, it is the only option . . . . We know the dollar is going to depreciate, so we hate you guys, but there is nothing much we can do.” Undoubtedly, pressure on the dollar is continuing and cracks are increasingly apparent. Possibilities abound – instead of the dollar as the singular hegemonic currency, we could have regional currencies instead. Emerging markets, whether BRICS or some other combination, could establish competitive currency zones. “[S]udden reserve diversification, or the act of foreign

Currencies for Competitiveness 38 (Dec. 2009) (Discussion Paper) (proposing a greater role for SDRs through new rules permitting the private sector to issue its own SDR instruments.); Chatham House Report, Beyond the Dollar: Rethinking the International Monetary System, at ix (Paola Subacchi & John Driffil eds., 2010 (proposing a “multicurrency reserve system . . . alongside a still preeminent dollar.”). For a summary of other proposals, see Emily Merki, Why the Dollar Should No Longer Be the World Reserve Currency: Solving Global Account Imbalances Through Structural Reform, 46 GEORGETOWN J. INT’L L. 1245, 1253-1270 (2015) (discussing myriad reforms – international harmonization of bank capital requirements; increasing supervision of international capital movement; minimization of instability caused by massive accumulation of dollars through exchange rate adjustments; multi-currency reserve system; creation of a freestanding reserve currency backed by gold).


As an example of rare legal scholarship on the dollar as world reserve currency, see Wu, supra note 264, at 14 (ascribing the following as reasons for dollar decline: “the unwillingness of others to hold it as a reserve currency, balance of payment deficits, the drop in American gold holdings in relationship to the growing foreign-held dollars, and the massive transnational movement of capital.”).


Id. In May 2009, on a visit to China, then Brazil’s president, Luiz Inácio Lula da Silva, echoed Chinese frustration, calling the world to “stop denominating trade in dollars.” Id.

Zanny Minton Beddoes, From Emu to Amu? The Case For Regional Currencies, FOREIGN AFF., July-Aug. 1999, at 8 (European monetary union vs American monetary union).

Wu, supra note 264, at 29-34 (describing the possibility and viability of Big Emerging Markets (“BEM”) consisting of Mexico, Brazil, Argentina, South Africa, Poland, Turkey, India, Indonesia, China, and South Korea forming a monetary union, the BEMU). See also supra note 390.
governments abruptly shifting their funds from dollars to other currencies” is not farfetched. That disaster did not strike even after the 2008 financial crisis does not mean it will not ever strike. That there is, as yet, no effective alternative to the dollar does not mean that one will not emerge. Indeed, it is reasonable to note that it is the “eurozone phase of the global financial crisis . . . [that] . . . has provided the U.S. government with a timely respite from both domestic forces and Triffin’s endgame” and that what the United States got as a result was merely “a lucky break.”

As George Soros succinctly described, “in the financial sphere the Bretton Woods institutions—the IMF and the World Bank—have lost their monopoly position. Under Chinese leadership, a parallel set of institutions is emerging.” Soros noted that against this context of “rival camps” with China and Russia on one side and the U.S. on the other, “China has begun to build a parallel set of financial institutions, including the Asian Infrastructure Investment Bank (AIIB); the Asian Bond Fund Initiative; the New Development Bank (formerly the BRICS Bank); and the Chiang Mai Initiative, which is an Asian regional multilateral arrangement to swap currencies.” I have focused on the New Development Bank and on a myriad of other actions, from the various China-Russia bilateral agreements, the historic gas deal, to demonstrate that the hegemony of the dollar is being eroded as more and more countries seek to price oil and gas in a currency other than the dollar, such as the yuan. Since the closure of the gold window, the dollar’s unique status has been maintained partly by its linkage to oil. Breaking the dollar-oil link will be a significant step bringing the world closer to a non-dollar-based regime. Hence, it is interesting to note that whereas Saddam Hussein moved to price oil in a currency other than the dollar, Iraq post-Saddam Hussein is now committed to selling oil in dollars.

---

397 Warnock, supra note 393 at 1-2.
399 Warnock, supra note 393.
400 Id.
402 Id.
403 See supra notes 274-276.
404 The current Iraqi Dinar exchange rate is now pegged to the U.S. dollar. Int’l Monetary Fund, Iraq Staff-Monitored Program – Press Release; and Staff Report, Attachment I Memorandum on Economic and Financial
The search for hard assets such as oil, gas, gold and other natural resources has also intensified. Gold in particular remains relevant to the international economy, despite vociferous claims to the contrary. It remains relevant despite prior efforts to demote it. Take as an example the move by the IMF in January 1976 to convert the SDR from a gold-backed reserve to one consisting only of a basket of paper currencies. Take as another example the dumping of 300 tonnes of gold by the U.S. during the Carter administration to depress the price of gold and to show that dollars, rather than gold, should be the global reserve currency.

China’s quest to internationalize the yuan and its recent inclusion in the IMF’s SDR basket reflect not only Chinese desire “to use financial liberalization as an engine of growth” but also its “ultimate ambition of replacing the US dollar as the dominant currency in the world.” It is not only China but Russia as well that has stepped up efforts to increase its own gold reserves. From 2004 to 2013, Russian reserves increased from 390 tonnes to over 1,000 tonnes.

Through QE, massive printing of dollars has upset the complex relationship between the dollar and other currencies tied to it, such as the yuan. Dollar devaluation has resulted in inflation in other countries, contributing to economic stress and political revolutions in many parts of the world. Moreover, The drive to repatriate gold in the post-2008-financial crisis world must be seen in this context – of growing mistrust in the global financial system, in the same way that mistrust during the Cold War drove Germany and other European countries to keep its gold stored in New York rather than risk confiscation by the Soviets on the other side of the Iron Curtain. “If the U.S. or the U.K. suddenly deemed it necessary to confiscate foreign gold to defend its paper currency in a crisis, that gold would be conveyed from the original owners to the

Policies 29 ¶ 18 (2016) (“The government will maintain the Iraqi Dinar’s peg to the U.S. dollar. The peg provides a key nominal anchor in a highly uncertain environment with policy capacity weakened by the conflict with ISIS.”).

Iraq Crude Oil Exports – February 2016, Republic of Iraq, Ministry of Oil, Mar. 25, 2016, https://www.oil.gov.iq/index.php (providing an export chart of Basrah Crude and Kirkuk Crude by its average barrel price in U.S. dollars); Carola Hoyos & Kevin Morrison, Iraq Steps Back into Oil Market with Crude Sale Offer, FINANCIAL TIMES, June 6, 2003, at 11 (describing post-Saddam Iraq offering of oil which “switches the transaction back to dollars – the international currency of oil sales – despite the greenback’s recent fall in value. Saddam Hussein in 2000 insisted Iraq’s oil be sold for euros, a political move, but one that improved Iraq’s recent earnings thanks to the rise of the euro against the dollar.”); Emily Glazer, Nour Malas & Jon Hilsenrath, U.S. Cut Iraq Cash on Iran, ISIS Fears, WALL ST. J., Nov. 3, 2015, A1. “Since the U.S. overthrew Saddam Hussein and helped establish the Central Bank of Iraq in 2004, the U.S. dollar has largely become the country’s chief currency because so much of the economy runs on cash. When Iraq needs more paper currency, the money is drawn from the country’s account at the Fed, funded largely by oil reserves, and flown to Baghdad.”).

Rickards, supra note 28, at 235.

Id.

Soros, supra note 401.

Rickards, supra note 28, at 229.
possession of the U.S. or the U.K.". As there is mistrust in paper money such as the dollar, there is an increasing demand to accumulate gold as a reserve asset. As Mario Draghi, head of the European Central Bank declared in 2013, “I never thought it wise to sell [gold] because for central banks this is a reserve of safety. It’s viewed by the country as such. In the case of non-dollar countries, it gives you a fairly good protection against fluctuations of the dollar.” This Article has connected seemingly disparate dots in the international economic system to warn about the dangers that lie beneath the dollar’s apparent strength. Before any serious efforts to defend the system can be mustered, the first task is to realize that positive snapshots, a rallying stock market, a strong dollar, a robust economic recovery, or a slowdown in China’s economy may in fact be deceiving because what lies beneath are fault lines that pose fundamental danger to the post-World War II international economic regime.

409 Id. at 231.

410 RICKARDS, supra note 28, at 236.

411 Common sense suggestions have been put forth. See, e.g., Warnock, supra note 393 (preserving dollar hegemony means bold fiscal adjustments to end “persistent borrowing from abroad . . . [to finance] persistent increases in government and household consumption.” Warnock, supra note 393. Some have focused on reforming the international financial system through regulatory mechanisms to manage systemic risks. See generally Yesha Yadav, The Specter of Sisyphus: Re-making International Financial Regulation After the Global Financial Crisis, 24 EMORY INT’L L. REV. 83 (2010). Others have proposed more coordinated international response focusing on “comprehensive exchange rate adjustments that would limit the destabilizing effect that accumulation of massive reserves in one currency has produced.” Juscelino F. Colares, Global Imbalances and Liquidity-Induced Bubbles: Reflections on the Great Recession and the Need for International Monetary Reform, 60 SYRACUSE L. REV. 603, 603 (2010). See also supra note 390.
