Question mark over role of US dollar

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The announcement by credit rating agency Standard and Poor's that it had downgraded its outlook on US debt to "negative" has sent a shudder through global financial markets. The decision means there is now a one in three chance that US debt itself will be downgraded over the next two years—an event without precedent.

More than the state of the US economy and government finances, however, is being called into question by the S&P decision. With US debt considered the safest in the world, any downgrading means that the role of the US dollar as the world's reserve currency will be severely undermined, if not ended altogether.

In response to the decision and the growing lack of confidence in all paper currencies, the price of gold has risen to a new high, reaching more than $1,500 per ounce.

Over the past decade, the dollar's role as the pivot of the global financial system has come under increasing scrutiny, as US debts have risen and the balance of payments gap widened, requiring an increasing inflow of capital from the rest of the world, especially China. But so long as the world economy kept growing, these concerns remained somewhat in the background. Things began to change when the financial crisis erupted in 2008, revealing the rot and decay—not to speak of outright criminality—at the heart of the American financial system.

Anxiety about the US dollar's role is being fuelled by the fact that far from being resolved, the global financial crisis that began with the collapse of Lehman Brothers two and half years ago has simply mutated.

Last weekend, billionaire financier George Soros warned that the present situation was more baffling and less predictable than at the height of the financial crisis. "There are clearly a number of unsustainable situations which nevertheless continue, and the authorities don't necessarily try to solve them, but merely to buy time. We live in this situation without an immediate collapse or an immediate solution confronting you."

In the wake of the S&P decision, former chairman of the Australian Securities Exchange, Maurice Newman, warned that the world economy was living beyond its means and heading for a cataclysmic shock within the next eight years.

"Nearly three years since the global financial crisis, the world economy remains on life support, despite the trillions of dollars of stimulus and monetary easing," he told a recent business lunch. Financial market volatility would "create a crisis" leading to "widespread trade and capital market dislocation." He predicted that the crisis would see the end of the US dollar's role as the world's reserve currency.

Moves in that direction are already underway.

Last week's third summit of the BRICS grouping—Brazil, Russia, India, China and South Africa—issued a communiqué declaring that the international financial crisis had "exposed the inadequacies and deficiencies of the existing international monetary system" and called for reform, based on a "broad-based international reserve currency system providing stability and certainty."

The statement pointed to one of the main causes of the present aggravation: the contradiction inherent in the dual role of the US dollar—as both a national currency and world money. In order to try to boost the US financial system and cover its trillions of dollars in losses—as well as to strengthen the position of American banks as they battle for global market share—the US Federal Reserve has provided hundreds of billions of dollars in cheap credit through its so-called quantitative easing program.

This has, however, created major problems for other economies. Money has poured into their financial systems, leading to inflation in food and other commodities as well as creating asset bubbles, especially in real estate.

The BRICS communiqué called for “more attention” to be paid to the “risks of massive cross-border capital flows faced by emerging economies” and warned that “excessive volatility” in commodity prices was threatening the global economic recovery.

The BRICS group’s call for a new international reserve currency system is not only a response to processes set off by the global financial crisis. It reflects longer-term developments, in particular the shift in the relative positions of the US and the so-called emerging powers within the world economy.

During the first decade of the twenty-first century, the BRICS countries reportedly averaged annual economic growth of more than 8 percent compared to just 2.6 percent for the industrialised countries. The recent announcement that China has displaced the US as the world’s leading manufacturing economy is symptomatic of this shift. The share of the BRICS in the world economy rose from 17.7 percent at the start of the decade to 24.2 percent in 2009, while in terms of additional world growth, the BRICS portion rose from close to zero in 1990 to more than 60 percent last year.

The BRICS’ call for a new international reserve currency recalls the proposal made by British economist John Maynard Keynes in the discussions leading to the Bretton Woods Agreement of 1944. Keynes wanted the financial system to be based on an international currency, “bancor”, not a particular national currency. The United States, however, used its economic dominance to defeat the proposal and the US dollar became world money. The system was anchored in a decision that US dollars would be redeemable for gold at the rate of $35 per ounce.

The new system was not a permanent solution. As world trade expanded and US foreign investment grew, together with overseas military spending, the mass of dollars circulating in international markets far exceeded the gold stocks held by the US. In August 1971, US president Nixon withdrew the gold backing from the US dollar.

For the past 40 years, the international financial system has nevertheless operated with the US dollar acting as world money. It has only been able to do so because of the relative economic superiority of the US over its rivals. But that superiority has now been undermined, and the international financial system is resting on the currency of one of the world’s biggest debtors.

The dollar, however, will not be replaced by some new form of international money, devised by the BRICS group or any other combination of capitalist powers. On the contrary, the ongoing financial storms and crises will see an increasing fracturing of the world economy into rival national currency and trading blocs, just as occurred in the 1930s. And like then, the outcome of these divisions will be deepening economic and political conflicts, leading ultimately to war.

The only way to prevent such a global catastrophe is through the development of an international political movement of the working class, based on a revolutionary program to overturn the outmoded capitalist order and its conflicting “great powers”, and to rationally utilise the world’s productive forces within the framework of a consciously planned international socialist economy.

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