Foreign-Currency and Monetary Geopolitics of United States and Its Effects on the Future of the International System

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ABSTRACT

The US dollar is still considered as the main strategic deposit among the currencies of different countries of the world and the policies of the World Bank and the International Financial Organizations have been and will always be influenced by the US economy. Despite the economic crises and commercial balance deficits in the United States, dollar has maintained its high position in and its domination over foreign exchanges and foreign-currency deposits of the countries. The novelty of the present research relies on its consideration of the political properties of the governments and the geopolitical effects of these countries on the position of their monetary and foreign-currency policies and consequently, on the international financial organizations such as the International Monetary Fund and the World Bank, which can determine the future of international economy and the political relations among countries. Our research proves that the political development of the United States and its geopolitical situation have been of the effective factors on dollar growth; and unless the competitors acquire such a relative advantage, they will not be able to seriously challenge the currency of dollar and the monetary policies of the United States, at least in a short time.

KEYWORDS: Foreign Currency; Monetary Geopolitics; Foreign Currency Competition; Universal Currency; Dollar Hegemony.

1. INTRODUCTION

Foreign-currency and monetary geopolitics is a concept which played a more important role in foreign-currency relations among countries after World War 2, which itself is resulted from the dissolutions of economic giants in Europe. Then, the United States became able to present its currency as a credible one in commercial exchanges and strategic deposits to the world (Blinder, 1996). At the end, after the dissolution of the Soviet Union, the domination of dollar over foreign-currency relations among countries completed this hegemony. Some other developed countries attempted to find a new replacement position for their currencies. Japan, England and Germany were among the countries which entered this competition with currencies of Yen, Sterling Lira and Mark. The emergent economy of China, which grew after 1980's and is now known as the second economic power after the United States, suggested the currency of Yuan. Finally, in 1999, Euro was announced as the main competitor of dollar. The economic downturn in the United States in 2008 was, however, a sign of the lack of complete reliability on the US currency (Domanci, Fender, & McGuire, 2011; Lin & Rosenblatt, 2012).

The currency of every country can potentially be converted to a universal and exchangeable foreign currency in international markets; this, however, happens only when such a currency is demanded from other countries, too (Chinn & Frankel, 2007). The increase of currency demand in global foreign currency exchange markets results in the discussion of currency geopolitics. It means that a country which is successful in providing its economic and political security will also be able to employ its currency as a globally valid currency to guarantee the assets of the countries and find its place among other currencies in currency competitions. However, the independent variable of strengthening a currency is not a circular and short-term attempt; rather it is the long-term security of investment and economic stability which will not remain hidden from foreign investors. Such a trend is clearly observed in case of the US dollar, which has proved itself as the dominating and hegemonic foreign currency in the world (Yifu, Fardoust, & Rosenblatt, 2012).

The hegemony of dollar has been challenged by euro and some newly emerged economic powers; the bilateral swap arrangements among some countries have also challenged US dollar and its future (Bondare, 2011; Lin & Rosenblatt, 2012). It is still, however, considered as a credible foreign currency in economic international
Geopolitics has been mentioned as a field of study where the relation between geography and policy plays a significant role. The concept of geopolitics is a result of the combination of geography with the science of politics. Geopolitics is the same as politics which have been viewed from a geographical point of view. Geopolitics is more discussed in the issues related to foreign policy and reveals the importance of its political geographical aspect in the form of decisions on foreign policy. Every country has its own geopolitical situation and no region of the earth has the geopolitical importance of zero. The geopolitical importance of countries is relative and directly results from its internal situation and conditions which become significant in its foreign policy (Cohen, The Geography of Money, 1998).

Although the term “geopolitics” was invented in 1899 by Rudolf Kjellen (Guzzini, 2010), geopolitical contexts as an intelligent tradition and an argument on government interests and certain identification policies date back to universities, geopolitical institutions, and Empire research centers of the 19th century (Toal, 1996). This is the same era concurrent with the global growth of imperialism in which imperialistic governments attempted to justify and legalize colonial expansionism. They mostly discussed the concept mentioning geography was a science and tried to present it as a scientific order. The intellectuals of this era discussed issues such as the effect of geography on governments and the foreign policies derived from geographic contexts. Some intellectuals such as Alfred Mahan, Halford Mackinder, Friedrich Ratzel, Rudolf Kjellen, Karl Haushofer, Nicholas Spykman, and George Kennan have mentioned the relation between geography and policy (Cohen, The Geography of Money, 1998; Eichengreen & Temin, Fetters of gold and paper, 2010; Kirshner, 1995).

The period between the end of the 19th century and the end of the Second World War can be known as the golden age of classic geopolitics, both in theory and in practice. Since the 19th century, political competitions increased such that all the important powers of that time such as Britain, Germany, Soviet Unions, and the United States, having their own geopolitical theorists, attempted to express, theorize and maintain the powers of their countries. These geopolitical theorists had both academic educations and scientific experiences, whose decisions were the basis of the decisions of their countries’ leaders and could severely influence the macro decision trends of their countries (Gokmen, 2010).

There was a time when a country’s geopolitics was only defined in terms of its military characteristics and fortifications against hostile governments. Nowadays, however, with the importance of the economic factor as the main factor of power and bargaining at a global level, the concept of geopolitics depends mainly on economy. The existence of suitable economic factors such as high per capita, huge markets, extensive, various and strategic productions, the desired economic growth, the security of investing, and predictability can be named as features strengthening the geopolitical situations of the countries (Kenen, 1983). This is the same important concept which is considered in this paper in relation with foreign-currency and monetary politics.

2. Global Economy: History and Evolution

In ancient times, most trades would be performed among countries or regions based on swap exchanges. When trading became important and various, suitable common goods was required to be used in exchanges. Metal was of the choices which had inner value, since they were useful substances in goods construction. They could also be used in the formation of light and portable coins, compared to swap goods to be carried. The historians have categorized the use of metal coins in the world as follows:

A- Bronze coins which were transferred from Asia to Europe before Jesus’ birth.
B- Gold and silver coins which generated a greater flow in the economy of the next centuries (Williams, 1997).

The coin monetary system was very successful during the industrial revolution and this success continued in the next decades. There have been many discussions on the stability of coin economic system in universities and economic centers (Yifu, Fardoust, & Rosenblatt, 2012). This system continued over the period of 1850-1873 and continued until the period of California Gold Rush. The effects of such an extensive distribution of the metal of gold ended this era; but, the combination of the political and economic factors being influenced by the end of the war between France and Russia caused the complete end of metal coin monetary system throughout Europe (Flandreau, 2004). Britain had reached to the gold-backed standard policy a few decades before that. Eventually, Gold and silver were selected to be used in coin construction.

The phrase “international monetary system” has been changed throughout history. In modern era, however, it has been used to define different mechanisms, organizations and institutions which organized foreign exchange system, like what happens in monetary and investment exchanges. An international currency has three features:

A- A valuable resource which is used through allowing exchanges and transactions at any time and any
place;

B- An intermediate tool in exchanges (a valid foreign currency in efficient exchanges versus swap exchanges); and

C- A unit for monetary computations (Kenen, 1983) and also storing value function in formal exchanges and using a foreign currency as store of value which can be used in internal and international exchanges when other functions in an economy support the common foreign currency as “an international currency”. In other words, money gradually acquired three particular characteristics which had no alternative:

- As a value criterion,
- As an exchanging tool, and
- As a tool for store of value

The historical era of monetary system evolution is divided to sub-categories which are: gold standard era (1819-1914); interwar period (the end of the first World War and the beginning of the second World War) (1914-1939); the system after the second World War and the beginning of Breton Woods system (1964-1973); and the present era after Bertron Woods system which continues from 1973 until now (Kirshner, 1995; Chinn & Frankel, 2007; Williams, 1997).

3. The Trend of Global Monetary and Foreign-Currency System Change

3.1 Gold Standard System (1819-1914)

Gold standard system was first formed in Britain in 1819. Other countries in Europe continent, Japan and the United States of America used gold standard as the basis of their currency in the next generations. Most countries followed the gold standard in 1880. The exceptions, however, were China and India, which followed silver standard, having stored silver (Leavens, 1936).

The most important responsibility of the countries’ central banks was to establish and protect the formal balance between the common money with gold, under gold standard system. In order to keep this price unchanged, central banks required to have huge stores of gold. During this period, the surplus or deficit in the payment balance had to be invested through gold exchange among central banks and this would be done from countries having deficit to the countries having surplus (Bondare, 2011).

Classic gold standard age can be known as a significant era in the history of global economy; it was the time when commerce grew. Experimental studies proved that gold standard has positively distributed the growth of the global commerce over the period of 1880-1910 (Lopez, Ernesto, & Meissner, 2003). The exchange rates were generally constant and there was a free flow of workers and investments in political boundaries. That was a peaceful period (Chernyshoff, Jacks, & Taylor, 2009). Nevertheless, the global economy was suffering a huge downturn in the 1890's (DeLong, 1999); a severe recession occurred in 1907, which was followed by some smaller ones. These occurrences revealed that policy makers and central banks had determined the acquisition of foreign balance as their first priority; consequently, internal balance and gold stocks would be sacrificed.

3.2 Interwar Period (1914-1939)

The gold standard system collapsed during the Second World War (1914-1918). It was revitalized, however, as the system of gold exchange standard over the periods of 1925-1931, under which England and the United States could have gold stocks, while other countries were allowed to store gold and store dollar or sterling pound as stocks with the aim of avoiding the occurrence of any problem related to their gold stocks. A huge recession was felt fast by main banks at an international level. Britain had to stop using gold standard system in 1931, when foreign possessors of sterling pound were trying to exchange their money with gold. After that, other countries decided to stop using gold standard system and allowed other foreign currencies to be exchanged freely in foreign exchange markets (Toal, 1996; Cohen, The Geography of Money, 1998).

The role of gold standard system may be important in transferring crises to an international level. During 1930's, most countries tried to maintain money standard policies. Countries, based on the defined consistency mechanism by the complicated model of gold standard, attempted to get the ultimate inflation policy through contractile monetary and tax policies in order to avoid facing a reduction in international commerce. Inflation debugging mechanism, however, did not operate fast in other classic policies and it was not as easy as being theoretically mentioned. Besides, protecting goods commerce or controlling the flowing investments as a temporary cure were used to maintain gold stocks which itself had more effect in worsening the economic downturn (Eichengreen & Temin, Fetters of gold and paper, 2010).

3.3 Bretton Woods System (1946-1973)

In 1944, near the end of the Second World War, the representation of the united nation organization gathered in Bretton Woods and New Hampshire and reached to an agreement on establishing a modern economic system after the war. The aim of this new system which led to the creation of the International Monetary Fund
(IMF) and the World Bank was to avoid the damaging economic policies causing "the great recession". The rate of stable exchanges versus US dollar had a fixed price in which every 35 US dollars was equal to one ounce gold. Other member countries could keep their foreign currency of dollar and they could also sell their dollars to Federal Reserve in the United States, exchanging with gold based on formal price. The International Monetary Fund was formed to support the process of payment balance. Due to the main role of the International Monetary Fund as a distributor of the reserved foreign currencies, the United States intended to fix the value of its dollar on the basis of gold parity and guarantee that foreign banks could exchange their dollar reserves with gold in a specified scale. This imposed some limitations on the monetary policies of the United States. However, the complexity of the national and macro economy of the United States was increasing in the middle of 1960's and some difficulties and troubles occurred for this system due to the financial needs of Vietnam War and the increase of social costs resulting from the plan of the "great society" by President Johnson. Consequently, the gold reserves of the United States were gambled on in 1968 and Bretton Woods System collapsed after three consecutive years in 1971 (Yifu, Fardoust, & Rosenblatt, 2012; Triffin, 1960).

3.4 Post - Bretton Woods (since 1973)

The Adaptable Stabilizer System which was operationalized in 1946, continued until the early 1970's, in which internal conflicts caused the complete dissolution of this system. One of the inherent conflicts was actually the "Griffin dilemma", claiming that when the final provider of cash and foreign currency showed signs of global economic growth, the United States would need to increase dollar supply more than its stagnant gold which resulted in the decrease of dollar negative value and its invalidity (Triffin, 1960). Therefore, Bretton Woods System became severely indefensible and collapsed whose factors were the severe expansionary economic policies. The market exchange unit in Bretton Woods System was finally stopped in February 1973 and all the main and common international foreign currencies became floated in March, 1976 (Eichengreen, Three Perspectives on the Bretton Woods System, 1992; Frankel, 1995).

In attempts to save Bretton Woods System, some suggestions were made to replace the reserves in dollar through the formation of assets. The Special Drawing Right (SDR) was created to arrange the international debts under the supervision of the International Monetary Fund (IMF). In order to keep the price of dollar fixed against the price of gold, SDR was arranged on the basis of equality with one dollar. SDR is still used as a computation unit, even after three decades. When the members of IMF buy SDR (for example borrowing from IMF), real costs (expenditures) are computed in dollar, euro or yen depending on maximum and the priority of borrowing. The costs are computed in efficient national monetary units (reserve currencies) only when the loan is registered in SDR (Eichengreen, Three Perspectives on the Bretton Woods System, 1992; Yifu, Fardoust, & Rosenblatt, 2012; Chernyshoff, Jacks, & Taylor, 2009).

Another suggestion based on SDR became known as the creation of a reserve account (IMF, 2011). This suggestion was made when other countries attempted to exchange their dollars with other currencies or goods; thereby, countries could exchange their dollars through SDR. Finally, the ratio of exchange risk for IMF balance sheet remained. For example, if the value of dollar decreased versus SDR, IMF and its stakeholders would suffer a loss. Some other suggestions were made in early 1970's in which the US government could cover these losses or guarantee their non-occurrence. No success happened and the suggestion of a reserve account was never implemented.

Although no consensus exists in regard with the main reasons of Bretton Woods System collapse, some justifications seem useful. Among them, cases such as the differences between the United States and foreign monetary policies, differences between the United States and foreign tax policies, the inability of countries having balance deficit in reducing the prices, the failure of the countries having surplus in re-assessing their monetary policies, periodic reductions in international competitions with the United States, and huge structural defects in the international monetary system such as SDR under gold standard system can be mentioned (Eichengreen, Three Perspectives on the Bretton Woods System, 1992).

The defects of Bretton Woods System were such that eventually led to the creation of a global economic crisis in 2008. The potential of interest conflicts among macro policies in the direction of countries’ internal goals versus the role of dollar as a saved exchange had become universal. Monetary and tax policies of the United States have been inevitably based on internal and national concerns. These policies have also been prioritized based on their national and internal concerns which can be harmful in global strength and stability.

4. Monetary and Currency Geopolitics

There are some differences between the above mentioned international currency and monetary policies with monetary and currency geopolitics. International currency and monetary politics are employed in organizing the exchanges at a global level, while monetary and currency geopolitics are especially used in strengthening the economic and political situation and the position of a country at a global level (Blinder, 1996).
What is nowadays known as soft power in modern literature is not necessarily the countries’ indicated power, but their economic power. Economic power, economic security, investment security, and predictability of an economy in long term can add to the importance of a currency at a global exchange level. None of us may know the currencies of African countries, yet we can clearly find out the amount of the exchanged value and our profit in case of using euro or dollar as our exchange unit. We can always find the relation of the value of our currency. This mentality is the product of an economy which has been successful in stabilization of its currency (Chinn & Frankel, 2007; Gokmen, 2010).

The power of a currency depends on the issue of geopolitics. For example, a powerful and suitable geopolitics can strengthen the monetary and currency system of a country and consequently, the particular situation of an economy; at the end, a powerful currency can strengthen the countries’ geopolitical positions regarding regional and global issues. For instance, the United States can be named whose geopolitical situation in the Second World War and being far away from destructions of the direct war with axis powers could result in a better situation in the war and its economic dominance over the allies. China, India and Brazil are other countries whose new economic powers and their high and continuous economic growths resulted in their important roles in regional and international political issues and the strength of their geopolitical situations (IMF, 2011; Yifu, Fardoust, & Rosenblatt, 2012).

The concept of geopolitics is usually used about the issue of international competition among great powers. Conflicts on realms among certain trans-regional governmets are considered as the geopolitical issues; therefore, conflicts can be placed inside the geopolitics. In geopolitics, interest conflict is of utmost importance and down-to-earth people will never own lands. International Monetary and currency policies can be influenced by these conflicts, considering a geopolitical approach. A country which can prove its dominance over international conflicts, can also organize the international monetary and currency policies in accordance with its needs and interests. Therefore, humanity and morality are not discussed in monetary and currency geopolitics at all. The only important issue is the countries’ interests. The same is true in case of the common currencies which have become increasingly competitive in the recent years. These competitions are among the credible currencies at a global scale. Monetary relations have severely become conflicting. As a consequence, those monopolizations being historically governed by the governments are collapsing and the market itself is taking its charge (Cohen, The Geopolitics of currencies and the future of the international system, 2003; Kenen, 1983).

5. Dollar Hegemony, Advantages and Challenges

What is the current geographic concept of money? Currently, dollar is still the global currency. In fact dollar is the only real common currency being used for all intermediate and monetary exchanges. Not only is dollar used as a unit of computations and value saving, it is also credible in every countries of the world. The United States gains significant political advantages due to the dominant portion of dollar in the global market. The main question, however, is: Can the dominance of the dollar be changed? The answer consists of two parts in terms of the logic of market competition and the analysis of government’s decision factor (Cohen, The Geopolitics of currencies and the future of the international system, 2003).

Regarding the logic of market competition, it is clear that dollar will continue its dominance over the exchanges. Two other foreign currencies have been recently used in the global scale and in other countries, which are the common currencies of the European Union known as euro and yen of Japan. These three mentioned currencies are geopolitically important. Neither euro nor yen, however, are able to compete with dollar so easily, whose reasons will be mentioned in the following lines (Cohen, The Geography of Money, 1998; Cohen, The Geopolitics of currencies and the future of the international system, 2003). All different internal and international types of dollar usage are advantageous for the United States, including economic and political advantages. In order to narrow down this issue, however, it is realized that the advantages of market leadership in common currency-related issues such as dollar is potentially an important issue. The most important potential abilities are the seigniorage, printing and possession of money. The extended radius of the money along the borders acts as a grant-in-aid and a free loan for a country, which can be considered as a real source for all the economic sections (Williams, 1997).

When the governments’ priorities are analyzed, however, the scenery becomes more ambiguous and competitive. The European and Japanese will do their best to employ their currencies in the market of global exchanges; Japan can severely challenge dollar and its dominance in eastern Asia, as well as Europe which can start a battle against dollar in the middle-east. There is a high probability of a currency battle which can endanger more security and political interests of the both parties. The bilateral and multi-lateral commitments among these three great powers are not possible to be compromised; therefore, the confrontation of Japan, the European Union, and the United States is unlikely due to their common interests (Cohen, The Geopolitics of currencies and the future of the international system, 2003). As was mentioned before, the US dollar has been a fixed factor in
every international monetary systems, whether when its equivalent was gold and whether in new policies which has kept its dominance, regardless of the reduction of its previous value and instability with gold along with other currencies’ floating.

Here, some of the opinions of the US Federal Reserve are mentioned: the current stored profit resulted from the foreign flow of dollar is yearly estimated as about 16-22 billion (Blinder, 1996; Flandreau, 2004). It is often called the “neglected resource royalties among other international exchanges”.

In this regard, the authorities have stated: "the effect of the international currency of dollar reduces the real costs of the US government which has to pay". Their suggested "cash rebate" is yearly estimated as 5-10 billion dollars. Putting these numbers together, remember the words of the previous republic senator, Everett Dirksen, on federal budget issues, stating: "let us express our opinions on the real money" (Portes & Rey, 1998).

The second advantage of the internal money credit is its flexibility increase in macro-economic policies which results in investments and savings outside the country. The extension of money flow over the borders reduces the real cost of adapting with unpredictable expenditures in practice; nevertheless, it can be used as a source in foreign exchanges. A powerful currency such as dollar reduces the concerns about the balance of payments and costs in relation with the internal regulation policies (Eichengreen, Three Perspectives on the Bretton Woods System, 1992).

The third advantage of a credible currency can be considered from a psychological point of view. This psychological state is the acquisition of a prestige which is caused in human minds due to the dominance over the market. Money has always had a key continuous role for governments and acts like flags, national sings and postal stamps which induce a sense of national identity (Cohen, The Geography of Money, 1998).

The winner of the Noble Prize, Rubert Mundell believed: "powerful governments have always powerful currencies" (Mundell, 1993). Therefore, dollar has become the potential symbol of the United States’ superiority. For instance, scholars such as Joseph S. Nye have called the power of the United States the “soft power” which acts through affecting and shaping the beliefs, feelings and conceptions. The determination of the quantity of these psychological effects is difficult, however, the role of credit and fame in Geopolitics should not be underestimated (Nye, 1990).

So, what will be the effects of the logic of the market on dollar? Can the dominant realm of dollar be changed? As was mentioned, the real competitions of dollar are yen and euro. But the logic of the market shows that none of these can compete with dollar on its own. Eventually, it must be said that the market players will always continue their references to the dollar (Cohen, The Geopolitics of currencies and the future of the international system, 2003). But, is the dollar hegemony system being replaced with a real multi-currency system with other international powers present? This question will be investigated in discussion section.

In the recent years, with the significant growth of countries such as China, India and Brazil, it is expected that these emerging powers become able to assign more international credit to their currencies. By the entrance of other countries to international levels, single-polarity is collapsing and the monetary and currency policies are moving toward more convergence geopolitically with maintaining the relative dominance of the dollar. The following data being presented by the gold global council clearly shows the gold reserves of the US government and its nine countries behind.

![Diagram 1. Gold reserves by country, Quarter 2, 2011 (courtesy: World Gold Council).](image-url)
Besides, considering the reports of IMF, the increasing trend of the price of gold in the recent years, and also regarding the US government ability in controlling the inflammation ratio (from 1992-2012) (diagram 2) (diagram 3), it can be concluded that the US government was able to maintain its economic dominance and the amount of its assets in gold and dollar in relation with its closest competitors, regardless all its budget deficits and the periodical crises, the most severe of which happened in 2008. Therefore, as was observed in the recent economic crisis, the US government could not overcome these crises with the help of some emergent economic powers such as China; consequently, what was expected from the monetary and currency geopolitics in future could not be achieved without strengthening some of the new emergent economics in the east, South Asia and Latin America. The following table shows 24 countries in terms of currency and gold reserves and GDP (Kreps, 1934).


Table 1. Gold holding and Forex reserves, Quarter 2, 2011 (Courtsey: IMF, World Gold Council and Chatham House calculations).
Considering this table, the abilities of the emergent economic powers will be clear which has only one message for the international monetary and currency economy which is as below:

"We have our portion on the global economy, too. Therefore, we are trying to redefine our country's position in monetary and currency geopolitical decisions."

CONCLUSION

While the most of the international currencies are less used over the borders, the realm of the US dollar and euro are always increasing there. Non-American citizens have considerable amount of US dollar. The credit dollar reserves outside of the United States are about 5.8 trillion which is equal to 12% GDP (Gross Domestic Product) excluding the US (Fender and Mc Guive, 2011).

The United States, being known as the world's savior, could assure people of other countries to use dollar in their investments. After that, governments announced the amount of the assets in universal currencies such a dollar, and most of all, set their commercial and balancing policies, applying their monetary policies and equalizing their currencies in relation with dollar. The economy of the United States, however, had some advantages. If the characteristic of the American democracy is added to the previous branches, the economies such as China's will face some challenges in competitions. Therefore, the United States can be optimistic about their currency future and the consistency of international monetary systems with their own policies. Despite the challenges caused by euro, yen, pound and mark for the US dollar, the US dollar is still the dominant currency in exchanges and the assessment of the countries' assets, at least until the creation of a political and economic alternative like the US dollar. This phenomenon can direct the international system to a way which can tie the global security with the security of the United States. Since the strategic currency reserves of nearly all countries are in dollar, the weakness or endangering dollar hegemony and its consecutive value reduction in the short term will lead to balance crises and budget deficit in all countries, whether directly or indirectly. This issue is entitled as the monetary and currency geopolitics of the United Stated and its effect on the international system.

Financial crises are of common phenomena in internal and external economy which have too much economic cost for the countries. For example, the recent crisis in 2007-2008 which was caused due to the weak
economic performance of the United States in house market and the artificial reduction of the profit ratio spread so fast to other countries. This clearly shows the interwoven nature of global economies to each other; it also mirrors the economy weight of the United States.

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