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Theorizing dollar hegemony, Part 1: the political economic foundations of exorbitant privilege

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Abstract

This paper explores dollar hegemony, emphasizing it is a fundamentally political economic phenomenon. Dollar hegemony rests on the economic, military, and international political power of the US and is manifested through market forces. The paper argues there have been two eras of dollar hegemony which were marked by different models. Dollar hegemony 1.0 corresponded to the Bretton Woods era (1946-1971). Dollar hegemony 2.0 corresponds to the Neoliberal era (1980-Today). The 1970s were an in-between decade of dollar distress during which dollar hegemony was reseeded. The deep foundation of both models is US power, but the two models have completely different economic operating systems. Dollar hegemony 1.0 rested on the trade and manufacturing dominance of the US after World War II. Dollar hegemony 2.0 rests on the Neoliberal reconstruction of the US and global economies which have made the US the center of global capitalism and the most attractive place to hold capital. It is a financial model and intrinsically connected to Neoliberalism. Consideration of dollar hegemony leads to two further questions. One is whether there is a better way of organizing the world monetary order, which is associated with debate about the possibility of a new Bretton Woods. The other is what is the future of dollar hegemony?

Keywords: Dollar hegemony, Neoliberalism, power, currency competition, capital mobility, Bretton Woods.

JEL refs.: F00, F02, F30, F33.

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1. Introduction: revisiting dollar hegemony

The US dollar is the world's dominant currency measured by the value of trade invoiced in dollars, the denomination of international lending, and the share of central bank foreign exchange reserves held in dollars. As such, the dollar constitutes the world's hegemonic currency. That standing increases US power and yields significant economic benefits, which former French Finance Minister Valéry Giscard d'Estaing referred to in the 1960s as "exorbitant

privilege".[1] This paper revisits the theory of dollar hegemony and examines the past and present of dollar hegemony.

To the extent currency hegemony is even addressed in mainstream economics, the theoretical approach can be described as "functionalist" with the hegemonic currency being largely explained in terms of delivering better on the functions of money. The paper seeks to expand that frame by adding a "structuralist" dimension whereby currency hegemony is explained as the product of political economic structure. That approach joins economics with the political science sub-discipline of International Political Economy (IPE) which has long emphasized the significance of structural factors.

The principal novel analytical contributions of the paper are fourfold. First, the paper provides a simple political economic framework showing how political and economic power interact to support dollar hegemony, and how dollar hegemony feeds back to support political and economic power. A political economic frame emphasizes the role of state power. It contrasts with economists' thinking which looks to explain dollar hegemony as a market equilibrium outcome produced by agents' competitive pursuit of their self-interest. The economist's market equilibrium narrative suppresses politics and state power. It is both always right and always misleading. It is always right in that in the moment market forces determine private sector behaviors and asset demands. It is misleading because private sector behaviors and choices take place within an economic structure established by state power and states also have their own demands for FX reserves. The political is therefore intrinsic to understanding economic outcomes generated by the international monetary system (IMS), as emphasized by IPE.

Second, the paper re-examines the history of dollar hegemony and shows how it has had

[1] Cited in Eichengreen (2011, p.4).

a changing operational basis. The phenomenon of dollar hegemony has endured for seventy-five years, but its operational basis has changed. Power (in its various forms) is always the foundation of currency hegemony, but the way that currency hegemony operates varies with economic structure. The economic functioning of dollar hegemony in 2022 is very different from the economic functioning of dollar hegemony in the 1952. Recognizing that role of structure surfaces new theoretical explanations of how dollar hegemony operates.

Third, the paper emphasizes the relational role of hegemony. Hegemonic standing is a relational construct. The implication is dollar hegemony is not made by just the US. Other countries contribute to it by policy choices and policy failures. It is easy to overlook that contribution by focusing excessively on US power. Dollar hegemony prevails in part because of choices foisted on the global economy by the US which is the system hegemon, but it also prevails because of choices made by other participants.

Fourth, the paper introduces a new characterization of currency hierarchy in terms of an inverted cone. The cone contrasts with the existing currency pyramid representation. It shows how currency hegemony is associated with size and quality of asset markets, which is captured by the cone's three dimensionality.

The structure of the balance of the paper is as follows. Section 2 provides some descriptive data on dollar hegemony. Section 3 introduces the concept of the currency cone and elaborates a political economic model of dollar hegemony. Section 4 discusses some analytical implications of the model. Section 5 explores the role of market forces in manifesting dollar hegemony. Section 6 applies the theoretical model to analyze the history of dollar hegemony. Section 7 further excavates why foreign interests have

embraced the dollar. Section 8 concludes the paper.

2. Some data on dollar hegemony

By way of beginning, this section presents some data supportive of the notion of dollar hegemony. Table 1 provides a range of financial indicators for the period 2000 - 2020. Row 1 shows the US share of global GDP which provides a benchmark for assessing the relative extent of dollar hegemony. There is a declining trend through to 2010, but the share has been flat since then. Row 2 shows the dollar share of country foreign exchange reserves, which is the classic metric of dollar hegemony. There is a declining trend, which is suggestive of diminishing dollar hegemony. Row 3 shows the ratio of the dollar FX reserve share relative to the US share of world GDP. The ratio far exceeds one (by over a factor of two) which would be the measure if the US share was equal to its share of world GDP. Furthermore, the ratio is flat, so that dollar hegemony is unchanged according to that metric.

Table 1. Financial data assessing dollar hegemony.

Source: Federal Reserve Board, The International Role of the U.S. dollar, Accessible Data, October 6, 2021. * = author's calculation.
https://www.federalreserve.gov/econres/notes/feds-notes/the-international-role-of-the-u-s-dollar-accessible-20211006.htm#fig1
https://www.forbes.com/sites/mikepatton/2016/02/29/u-s-role-in-global-economy-declines-nearly-50/?sh=ad057d45e9e7

	2000	2005	2010	2015	2020
1. US share of global GDP (current dollars)	31%	28	23	24	25
2. US dollar share of global reserves	71.1%	66.5	62.2	65.7	58.9
3. Ratio of dollar reserve share to US GDP share*	2.29	2.38	2.70	2.74	2.40
4. Share of cross-border banking claims denominated in dollars	57.2%	55.8	56.4	62.1	60.8
5. Ratio banking claims to US GDP share*	1.85	1.99	2.45	2.59	2.43
6. Share of cross-border banking liabilities denominated in dollars	53.9%	53.0	54.2	63.9	57
7. Ratio banking liabilities to US GDP share*	1.74	1.89	2.40	2.66	2.28
8. Dollar share of foreign currency debt issuance	72.7%	73.4	66.0	65.8	64.7
9. Ratio of debt issuance share to US GDP share*	2.35	2.62	2.87	2.74	2.59

Rows 4 – 7 show the extent of dollar dominance in cross-border banking. The dollar share of cross-border banking claims and liabilities has increased slightly, as has the ratio relative to GDP share. That points to increased dollar hegemony in cross-border banking activity. Lastly, rows 8 and 9 show dollar hegemony in foreign currency debt issuance. Row 8 shows a decline in the dollar share, but row 9 shows the debt issuance share has increased relative to the US share of global GDP.

Table 2 shows the extent of dollar dominance in over-the-counter currency transactions. The dollar share of such transactions has remained stable, but it has increased relative to the US share of global GDP. Table 3 shows the share of US dollar banknotes held by foreigners which has increased steadily. This metric is indicative of the dollar's merits as a classic medium of exchange and store of value. It is also positively impacted by the size of the black economy outside the US, and negatively impacted by the decline in use of cash within the US. Table 3 shows an increase in the foreign share of dollar bank note holdings, showing that dollar notes continue to have standing with foreigners as a medium of exchange and store of value.

Table 2. Share of over-the-counter foreign exchange transactions.
(transactions sum to 200 percent as every FX transaction involves two currencies).
Source: Federal Reserve Board, The International Role of the U.S. dollar, Accessible Data, October 6, 2021.
https://www.federalreserve.gov/econres/notes/feds-notes/the-international-role-of-the-u-s-dollar-accessible-20211006.htm#fig1
https://www.forbes.com/sites/mikepatton/2016/02/29/u-s-role-in-global-economy-declines-nearly-50/?sh=ad057d45e9e7

	2001	**2007**	**2013**	**2019**
Dollar share of FX transactions	90%.	86	87	88
US share of global GDP (current dollars)	32%	25	22	24
Ratio of dollar FX transactions to 2 x US GDP share	1.41	1.72	1.98	1.83

Table 3. Share of foreign holdings of US dollar banknotes
Source: Federal Reserve Board, The International Role of the U.S. dollar, Accessible Data, October 6, 2021.
https://www.federalreserve.gov/econres/notes/feds-notes/the-international-role-of-the-u-s-dollar-accessible-20211006.htm#fig1
and https://www.federalreserve.gov/paymentsystems/coin_currcircvolume.htm

	2002	**2005**	**2010**	**2015**	**2020**
Share of foreign holdings of US dollar banknotes (at year end)	36.4%.	35.4	34.8	42.3	45.5
Total currency in issue ($ billions)	6829	760	984	1424	2081

Lastly, Table 4 shows the average annual use of the dollar for export invoicing over the period 1999-2019 in four regions of the globe. No trend can be determined as this is an average annual statistic. However, the dollar is totally dominant in all regions except Europe. The dominance is also huge relative to the US share of global GDP which averaged approximately 26 percent over the period. Thus, in all regions except Europe, the dollar export invoicing was close to three times the US share of global GDP.

Table 4. Average annual share of export invoicing, 1999-2019.
Source: Federal Reserve Board, The International Role of the U.S. dollar, Accessible Data, October 6, 2021.
https://www.federalreserve.gov/econres/notes/feds-notes/the-international-role-of-the-u-s-dollar-accessible-20211006.htm#fig1

Currency	Americas	Asia-Pacific	Europe	Rest of world
US dollar	96.3%	74.0	23.1	79.1
Euro	1.6%	5.0	66.1	14.2
Other	2.0%	21.0	10.8	6.7

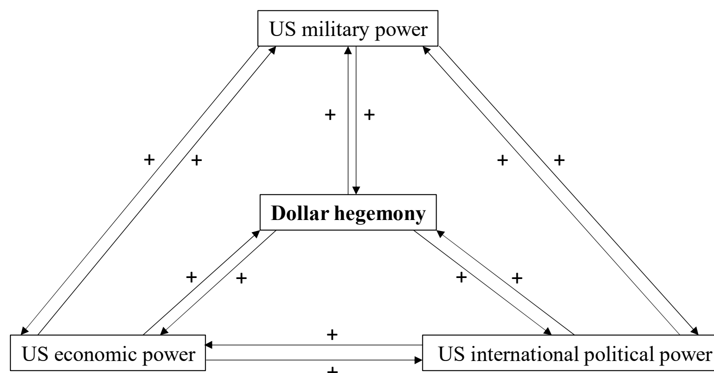
In sum, the evidence shows dollar hegemony is alive and well, measured by multiple different metrics. The only metric showing meaningful decline is the dollar's share of FX reserves, and even there the share has held up when measured relative to the US share of global GDP.

3. A political economic model of dollar hegemony

The next step is a theoretical model for understanding dollar hegemony. The model is termed a political economic model because political considerations and interests are inextricably present. That contrasts with the standard economic perspective which neglects those factors and focuses exclusively on market forces. The model is presented in Figure 1 and consists of four blocks: dollar hegemony, US economic power, US military power, and US international political power. The blocks echo Strange's (1989) seminal construction of power in terms of productive power, military power, knowledge power, and financial power which provided the foundation for her conception of the US as a transnational empire.

The four blocks are characterized by bi-directional interaction, with all affecting each other. Moreover, every interaction is characterized by positive feedback as represented by the plus signs, which generates a reinforcing feedback loop. An increase in the scale of the components of US power increases the extent of dollar hegemony and vice-versa.[2]

Figure 1. A political economic model of US power and dollar hegemony.
(+ = sign of impact effect)



3.1 Dollar hegemony

Dollar hegemony refers to the US being the world's dominant financial force, and it produces the pattern of empirical outcomes shown in Section 2. The dollar dominates central bank holdings of foreign exchange reserves, dominates international banking and international debt markets, dominates international trade invoicing, and is widely held as cash by foreigners. In extreme cases it may even entirely displace other currencies in their own home country, an outcome

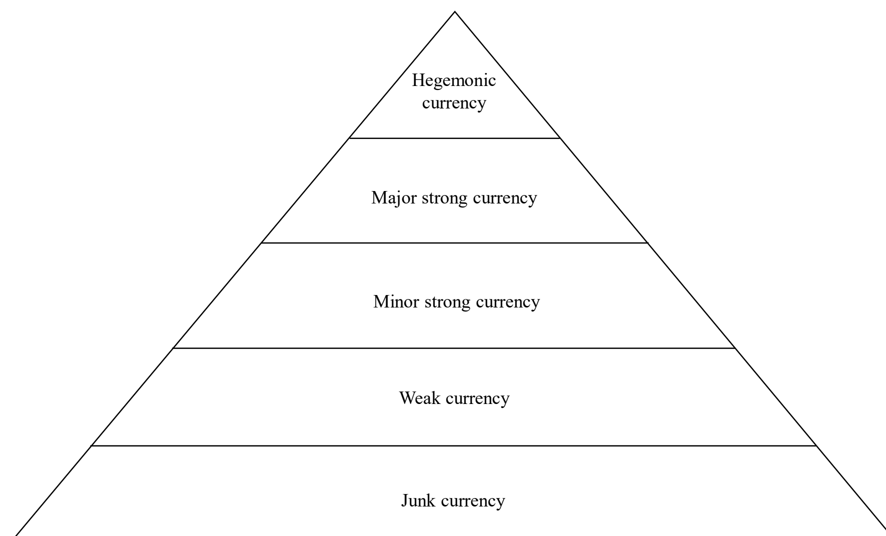
[2] In terms of a mathematical model of the process, the plus signs correspond to the signs of partial derivatives. The system in Figure 1 might be mathematically represented as a four-equation simultaneous model with the endogenous variables being dollar hegemony, US economic power, US military power, and US international political power. If the system is stable, it would exhibit strong multiplier effects because of the positive feedback loops. Increases in any one source of power unleashes developments that positively influence other sources of power, triggering feedbacks (multiplier effects) that further amplify the initial change.

referred to as “dollarization”.

Dollar hegemony is essentially a relational phenomenon that can be represented in terms of a currency hierarchy. Cohen (1998, p.116 – 118) describes that hierarchy as a “currency pyramid” which he identifies as having seven layers. Working from top to bottom, the layers are top currency, patrician currency, elite currency, plebeian currency, permeated currency, quasi-currency, and pseudo-currency.

Figure 2 presents a simpler more mundane pyramid consisting of hegemonic currency, major strong currency, minor strong currency, weak currency, and junk currency. The hegemonic currency is the equivalent of Cohen’s top currency; the major strong currency corresponds to the patrician and elite currencies; the minor strong currency corresponds to the plebeian currency; the weak currency corresponds to the permeated currency; and the junk currency corresponds to the quasi-currency and pseudo currency. From a functional perspective, major strong currencies play a role in the international economy and may be held as FX reserves by central banks. Examples are the Euro and Japanese Yen. Minor strong currencies perform all the standard functions of money (unit of account, medium of exchange, store of value) in the domestic economy but have no international role. An example is the Swedish krone. The Chinese Renminbi is a minor strong currency that is transitioning to major strong currency status. The Mexican peso is a minor strong currency that was a weak currency two decades ago, but it lives permanently in the threatening shadow of the dollar owing to Mexico’s proximity to and economic dependence on the US.

Figure 2. A suggested five category currency pyramid.



Weak currencies have lost some of their ability to deliver on the functions of money, with the store of value function being the one that tends to go first. Thus, a currency may initially lose its ability to be a store of value, but it is still used on a daily-basis and serves as a medium of exchange. It may also cease to be used in certain types of asset-related transactions. The Argentine peso exemplifies a weak currency. High inflation undercuts its store of value function, and it is not used in real estate purchases which are conducted using dollars. Junk currencies are those in which the currency has substantially lost its capacity to deliver on the functions of money. They remain legal tender, but another currency (e.g., the dollar) circulates widely in parallel. Parallel prices are quoted in dollars and dollars are commonly used as the medium of exchange. Of course, the currency hierarchy is a continuum so there may be judgement calls at the borders regarding which category a currency fits in. Currencies may also change categories as economic conditions and beliefs (i.e., credibility) about the currency change. Thus, a

currency's standing is endogenous.

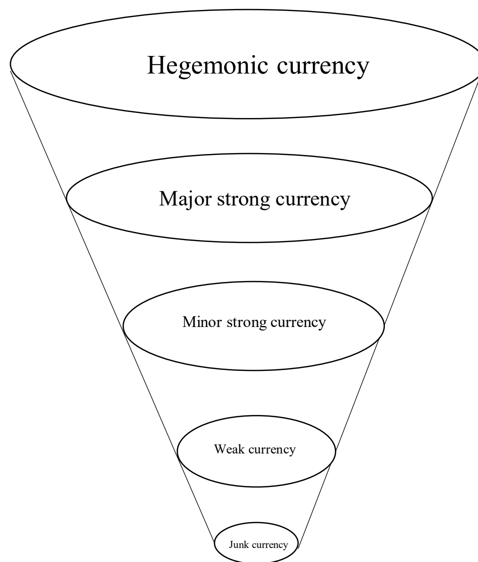
3.1.2 A currency cone rather than a currency pyramid?

Currency hierarchy ordering is influenced by the forces of currency competition. Cohen (1998, p.109-113) identifies those forces as currency internationalization (CI) and currency substitution (CS). The former promotes the use of a currency in the international economic sphere, while the latter has a foreign currency supplanting domestic currency. Those forces emphasize the relative ability of currencies to perform the classic functions of medium of exchange and store of value.

The argument developed in this paper is that contemporary dollar hegemony represents a form of systemic financial domination. Economic agents look to hold assets denominated in dollars, and not just use and hold dollars as money. They are drawn to dollar denominated assets owing to the US having deep liquid financial markets that offer an extensive asset menu. Those markets are part of a larger economic system which is structured to favor financial interests, and that economic system is advantaged and privileged by the network of power described in Figure 1.

A systems perspective suggests an alternative representation of currency hierarchy in terms of an inverted cone, as shown in Figure 3. The base end of the cone is at the top and the point is at the bottom. The categories remain the same: hegemonic currency, major strong currency, minor strong currency, weak currency, and junk currency. The area of each segment represents the depth, liquidity, and array of assets available in each currency denomination. Thus, at the top comes the dollar which dominates asset and liability denomination in global financial markets. At the bottom come junk currencies whose asset market representation is negligible, both in volume and quality.

Figure 3. The currency cone.



The cone representation captures the economic logic of currency substitution and currency internationalization. The hegemonic currency is advantaged by the quality of its financial markets measured in terms of market size, market liquidity, and the asset menu. Networking effects lower transaction costs, there are economies scale from spreading fixed costs over larger volumes, and the portfolio possibility span is larger. The structural financial advantage of the hegemonic currency can be thought of in terms of the ratio of cone slice surface areas. Junk and weak currencies are relatively more structurally disadvantaged against the hegemonic currency than are major and minor strong currencies, which is symbolized by their smaller cone slices.

The three-dimensionality of the cone is suggestive of the multi-dimensionality of dollar hegemony, directing attention to the systemic aspect. Anticipating the rest of the paper, it is essential to realize the US financial system is embedded in an economy that favors financial interests and the economy is advantaged by the underlying power of the US. Those deeper

structural features work to further advantage the US financial system and can be considered the true foundation of dollar hegemony.

3.2 Economic power

Economic power rests on a vector of factors including the size of a country's economy, the country's productivity and state of technological advance, its engagement in international trade and foreign direct investment, its accumulated net wealth, and the standing of its financial markets. That standing rests on the size of financial markets, their liquidity, the array of available assets, and the quality of governance. Moreover, everything is relative to the economic factors characterizing rivals. That relativity is intrinsic to the issue of power, about which more below.

It is the vector of factors that matters. Economic power is associated with size, but size alone does not make a hegemon, which is why the renminbi is not hegemonic despite China being the world's largest economy. Likewise, economic productivity matters but high productivity alone does not make a hegemon, which is why the Swiss franc is not hegemonic.

Nor are size and productivity sufficient. In the inter-way years (1919-1939) the US was the world's largest and most productive economy and had a high level of productivity and technological advance, yet the dollar was not hegemonic. At that time, the US still lacked the appetite for hegemony and sufficient engagement with the international economy. The lack of appetite reflected US international political withdrawal owing to the triumph of Republican foreign policy isolationism following the experience of World War I. Lack of international economic engagement reflected the continental size of the US which meant its economy could prosper without foreign economic engagement. There were plenty of internal investment opportunities as capital

was still scarce, a plentiful supply of natural resources and primary products reduced need for supply from international sources, and the domestic market was sufficiently large to support the economies of scale required by modern industry. After World War II, all the pieces for dollar hegemony were in place. The US was the global economic hegemon, it was politically ready to step up for a hegemonic role, and an opening (almost a vacuum) had been created by the bankrupting of the UK and the disintegration of the British Empire caused by the two World Wars.

3.3 Military power

The third block is military power which refers to the size and capability of a country's armed forces. Here, one might distinguish between "defensive" and "offensive" military capability. Offensive capability would seem the critical characteristic, being needed to project military force outside the hegemon's country in the service of the hegemon's interests. In the pre-1914 era of sterling hegemony, Britannia "ruled the waves" and it was the era of gunboat diplomacy. Since 1945 the US has been the unchallenged Western military hegemon, and since the end of the Cold War in 1990 it has been the unchallenged global military hegemon. China's military has only local defensive capability. A debated issue is whether China aspires to have global offensive military capability.

3.4 International political power

The fourth block is international political power which can be identified with diplomatic and "soft" power. It too consists of a vector of factors that includes economic, political, and military alliances; cultural leadership which includes global standing of a country's institutions of higher education; and multi-national business relationships that serve to link and ally countries.

The US is the undisputed international political hegemon, having been the leader of the

liberal international order since its establishment after World War II. It has leadership in all the institutions of the liberal order. Those include the North Atlantic Treaty Organization (NATO) military alliance, the United Nations (UN) system; the multi-lateral financial institutions (MFIs) which include the International Monetary Fund (IMF), World Bank, and the Inter-American Development Bank; and the Organization for Economic Cooperation and Development (OECD). The US leads the global trading system, being the hegemonic voice in the World Trade Organization (WTO), and it was the hegemonic voice in the General Agreement on Tariffs and Trade (GATT) system before that. It is the lead country in the Bank for International Settlements (BIS), the leader of the Organization of American States (OAS), and it has other bilateral and multilateral defense and economic cooperation agreements with multiple countries that are too numerous to list.

The US higher education system is regarded as the best in the world, drawing students from around the world. Most of those students return to their countries to exercise power and influence, inculcated with US thinking and points of view. Multi-national corporations (MNCs) are also a powerful source of international political power, with MNCs having influence in foreign countries and employing millions of foreign workers and executives. Those corporations have linkages into both foreign governments and the US government, with government affairs departments and trade associations being connected to the US government at the highest level. Just as MNCs can access the US government, the US government can access them. That source of soft power is symbolized by President Fox of Mexico (2000-2006) who was President of Coca-Cola

Mexico at one stage in his career.[3]

3.5 Linkages between US economic power, military power, and international political power.

The outer linkages in Figure 1 are well established and accepted, but for purposes of analytical completeness they are briefly recapitulated below. US economic power positively impacts US military power, with a large technologically advanced economy capable of supporting a large technologically sophisticated military. Economic power provides the US with the resources to ring the globe with military bases and deployments, and the US spends more on defense (as of 2021) than the combined defense budgets of the next nine biggest spending countries according to the Stockholm International Peace Research institute (Siddique, 2022). Data on US military deployments and spending are provided in Figures 4 and 5.

[3] In some regards, the US domination of the international political economic system is now so total that the construct of a liberal international order has become unsustainable. That construct was always open to realist questioning on grounds that such a system requires a benevolent hegemon to make it work, and a benevolent hegemon is ontologically impossible in a world of self-interested nation states. Now, given the scale of US dominance, the global order might be better described as a US international order. Before, it was a multilateral negotiated order that had the appearance of a liberal order because such an arrangement benefitted the US interest, especially in the Cold War era when the US faced challenges from the Soviet Union.

Figure 4. Global distribution of US military bases and facilities in 2020.
Source: American Geographical Society, https://ubique.americangeo.org/map-of-the-week/map-of-the-week-mapping-the-global-u-s-military-bootprint/

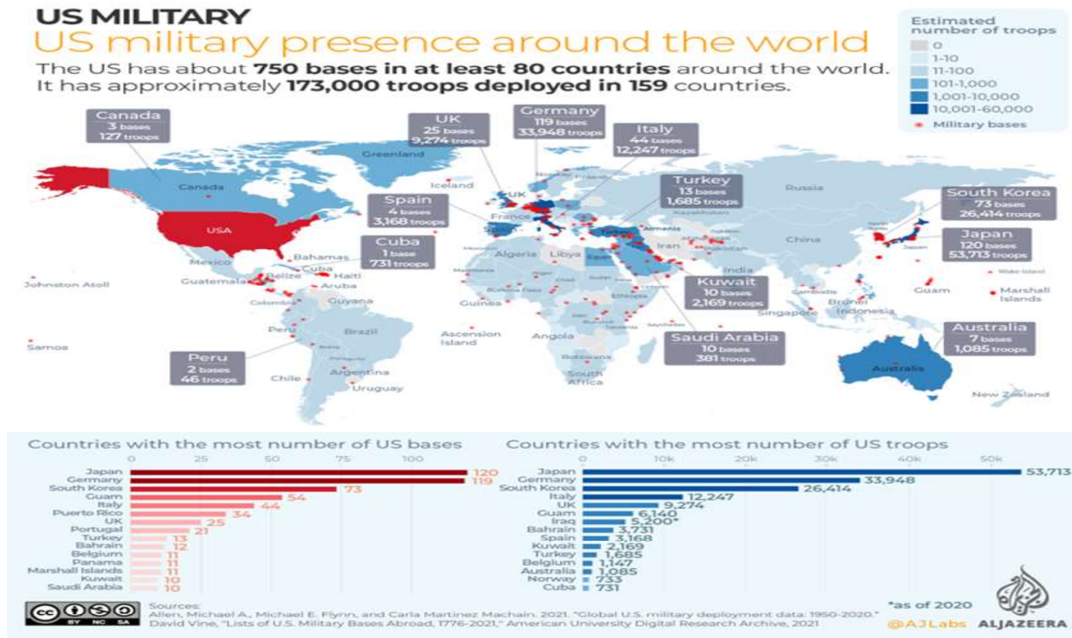
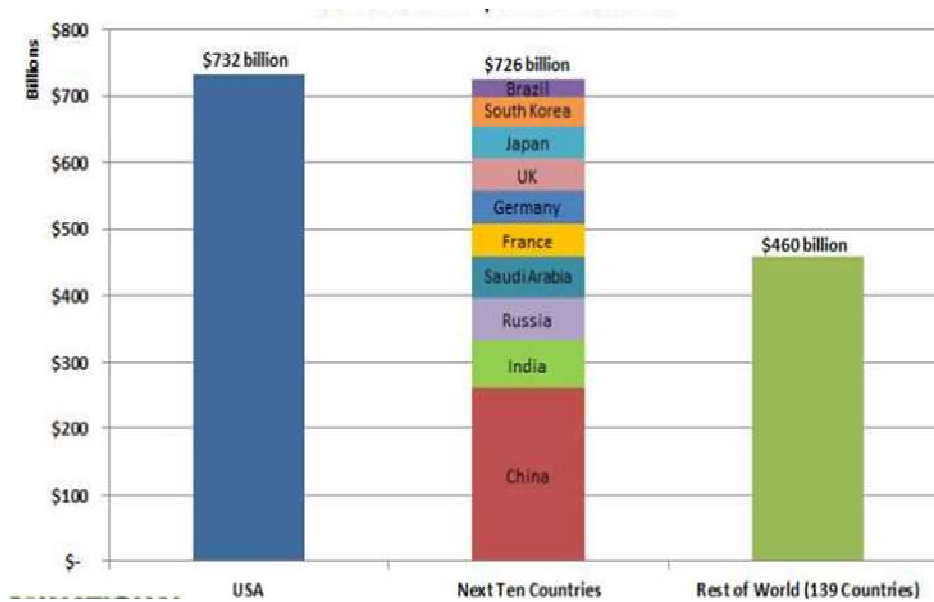


Figure 5. Military spending by country in 2021.
Source: https://www.nationalpriorities.org/blog/2022/06/22/us-still-spends-more-military-next-nine-countries-combined/



Likewise, the US's large and sophisticated military has positive impacts on the economy. Cypher (1987) argues the US military has played a role as a form of surrogate industrial policy, helping the private sector develop and commercialize new technologies. Mazzucato (2015)

details many of the technologies produced by that military-industrial policy.[4]

US economic power also positively impacts US international political power. First, it provides the resources to support US soft power initiatives. That includes directly financing foreign aid, educational and cultural initiatives, and diplomatic service-related initiatives. It also includes financing and justifying the dominant US presence in the IMF, World Bank, IDB, and other multilateral financial institutions. Second, the opportunities within the US economy provide an incentive for foreign countries to ally and do business with the US, with countries wanting trade and investment access to the US market.

Conversely, US international political power is good for US economic power. Thus, domination of the institutions of global governance enables the US to work them to the benefit of the US economy. Schwartz (2019) argues that has been particularly so with the new rules of global trade established under the WTO regime which have expanded intellectual property right (IPR) protections to the benefit of corporate profitability, with the US benefitting the most as it is the global leader in IP production (Soskice, 2022).

Similarly, soft power connections are a form of indirect investment in the US. US institutions of higher education attract foreign talent. Scientists and high-tech engineers often remain and add to US human capital. Meanwhile, economists and MBAs are inculcated with a US-friendly intellectual perspective and return home to become business and policy leaders. Business opportunities are significantly relational so that the relationships formed generate economically beneficial opportunities. Such relationships are also fostered by diplomatic service

[4] That said, there is also a dissident counterview which sees military spending as intrinsically unproductive, and such spending would generate greater returns and well-being if directed to other uses. That is the critique of military-industrial Keynesianism, but it can be accused of over-looking the global power dividend the US receives. The two views can be reconciled by arguing that the US over-spends (perhaps massively) on military might. By reducing and redirecting military spending, the US could have both: it would still retain the power and industrial innovation dividends, but it would gain the benefits gained from redirected spending.

activity and by the MNC - US government - foreign government network.

Lastly, there is a positive feedback loop between military power and international political power. Cypher (2016) examines how US military power enhances US diplomatic clout. Countries may seek protection under the US military umbrella, and the presence of US military bases may even send a subtle message of threat if countries do not conform. The line between occupying force and ally can be thin. Those influences show up in extensive alliances consisting of acquiescent allies. The size of the US military means it has preeminence within NATO, thereby creating a huge network of relationships between national militaries, defense contractors, and politicians. There is a revolving door between all three components of that network which further reinforces the network. The impacts of the network also ricochet back into the economy as the military - international political power network may then generate large orders for weaponry produced by the US aerospace and defense sector, which is a critical dynamic sector of the US economy.

3.6 Linkages between dollar hegemony and the components of US power

The political economic approach to dollar hegemony has been developed in the political science sub-discipline of IPE. That IPE literature is crisply engaged in a symposium in *International Studies Perspectives* (Norrlof and Poast, Eds., 2020, p.109-153). The model described in Figure 1 can be used to frame and organize that literature. The inner linkages within Figure 1 are the core. They show how US power augments dollar hegemony and dollar hegemony augments US power.

3.6.1 Economic power and dollar hegemony

The most obvious linkage is the impact of dollar hegemony on economic power. That impact is captured by Giscard d'Estaing's comment in the 1960s about the US enjoying an "exorbitant

privilege" owing to dollar hegemony generating asymmetric operation of the financial system. The notion of exorbitant privilege captures the idea that the US gets to enjoy the benefits of the international economy without sacrificing domestic macroeconomic policy capability. The US is substantially freed of an external balance of payments constraint, unlike other countries whose macroeconomic policy possibilities collide with the external constraint. That exorbitant privilege has only grown with the suspension of the Bretton Woods system in 1971 (about which more below).

There are multiple economic benefits from dollar hegemony. The most commented on is seignorage resulting from the fact dollars are near costless to issue but foreigners must give over real resources to acquire them. As of 2020, foreigners held approximately 950 billion in dollar notes, which is a very nice gift. However, even larger benefits come from other financial stocks. In 2020 the dollar constituted 58.9 percent of foreign country FX reserves, 33.8 percent of marketable US Treasury debt was held by foreigners, and 60.8 percent of international foreign currency banking claims and liabilities were dollar denominated.[5]

Those financial stocks have a magnitude in trillions. On some (e.g., Treasury debt) the US must pay interest, albeit at a favorable rate for reasons discussed below. However, US banks receive interest on banking claims that they generate, and the resource cost of such claims is essentially zero in a world of endogenous fiat money. That constitutes a significant perpetual "golden crumb" which the US enjoys by having the dollar be the money of the international economy. Those benefits are behind Desai and Hudson's (2021) construct of the US as a "creditocracy".

On top of the direct seignorage benefit, the US receives major financial market and

[5] Source: Federal Reserve Board, The International Role of the U.S. dollar, Accessible Data, October 6, 2021.

economic policy benefits. Being the dominant currency and having the world's dominant financial markets, increases the attractiveness of US financial assets. That attractiveness is enhanced by the dollar having "safe haven" status. First, since the US has more macroeconomic policy space owing to its exorbitant privilege, it is better able to stabilize the macroeconomy against shocks. Second, loans to the US are dollar denominated (i.e., the US borrows in its own currency) which means there is no risk of default as the Federal Reserve can issue dollars to repay those debts. Third, the lion's share of international lending is dollar denominated as shown in Table 1. US banks have access to the financial back stop of the Federal Reserve which can support them in the event of a financial crisis, thereby inoculating the US against financial crisis risk. The same is not true for foreign banks that make dollar denominated loans, which means foreign financial systems are more at risk.[6]

Fourth, dollar hegemony confers a privileged standing on dollar denominated assets. That standing increases demand for US financial assets, which lowers interest rates and increases US asset prices and wealth. That is good for aggregate demand and growth. US MNCs also have access to cheaper credit and can use their higher valued equity capital to buy foreign assets, effectively on the cheap.

Hausmann and Sturzeneger (2005) invoke the playful notion of "dark matter" to explain the superior US return on FDI compared to other countries, but it may just be a product of dollar hegemony and the cost of capital/rate of return profile it creates. US corporate purchases of foreign assets results in a change of ownership which dollarizes

[6] That risk effect was evident in the 2008 financial crisis when the Federal reserve initiated emergency currency swap arrangements with major currency central banks as a way of channeling dollar liquidity to those banks which they could then lend to their commercial banks. Those provisions continue in the form of now *de facto* permanent currency swap arrangements.

those assets, causing an upward revaluation. The reverse holds for foreign purchases of US assets, which results in dedollarization and a downward revaluation.

Caballero (2006) argues the world is short of safe assets and the US produces safe assets, which he claims explains the US trade deficit that is the result of the rest of the world seeking to acquire safe assets. That too may simply reflect dollar hegemony. The US produces safe assets because US financial markets are under the umbrella of dollar hegemony, and not because the US financial system is intrinsically better.[7]

Fifth, US firms benefit from lower transactions costs as they transact in their own currency, and they also avoid the cost of hedging exchange rate risk. On the downside, dollar hegemony appreciates the exchange rate by increasing demand for dollars. That is bad for manufacturing, though it also lowers import costs which benefits consumers and helps tamp down inflation.

In sum, dollar hegemony confers major economic benefits that enhance US economic power. Enhanced economic power then feeds back to enhance dollar hegemony through the mechanisms discussed earlier such as increased US economic size; deeper, more liquid, more stable financial markets; and engagement of foreign nationals in dollar denominated financial activity.

3.6.2 Military power, international political power, and dollar hegemony

Dollar hegemony also positively impacts military and international political power, and those impacts are examined concurrently as they involve similar mechanisms. Dollar hegemony creates the "exorbitant privilege" of fiscal space and freedom from an external economic constraint, which helps provide the US with resources for its expansive international military and

soft power operations (Oatley, 2015).

The other side of the loop has military and international political power supporting dollar hegemony. Perhaps the clearest example of military support is the 1974 petrodollar accord with Saudi Arabia (Gwertzman, *New York Times*, June 9, 1974). The House of Saud committed to price oil in dollars and recycle its petrodollar trade surplus via Wall Street in return for US military protection. The agreement ensured the global oil market would be priced in dollars, thereby cementing one of the pillars of dollar hegemony. The *quid pro quo* was security guarantees which the US could provide because of its military power. That episode and its antecedents are examined by Croteau and Poast (2020).

The literature on the security (military and international political) foundations of dollar hegemony is assessed in Norrlof (2020). Zimmerman (2002) provides details of the Cold War era tacit agreement between Germany and the US, whereby Germany held dollars and helped manage the dollar exchange rate in return for the US stationing troops in Germany that protected against the Warsaw Pact threat. US international political power also positively impacts the willingness of countries to hold dollar reserves by fostering alliances and political affinities with them. Liao and McDowell (2016) show countries that are politically distant from the US and close to China tend to hold more renminbi reserves.

The above political and economic benefits of dollar hegemony are not the musings of academics. They are clearly understood within the US government. Thus, Christopher Smart, former Special Assistant to the President at the National Economic Council and National Security Council and former Deputy Assistant Secretary of the

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[7] Palley (2012, p.112-114) offers multiple other critiques of the safe asset shortage explanation of the US trade

Treasury, writes:

> "Currency dominance has also been a linchpin in America's efforts to shape a global order around free markets and democracy while serving as a foundation for the sustained growth of a more integrated global economy…. Issuing the world's reserve currency offers the prospect to literally print money everyone accepts to buy guns without giving up butter. The dollar's dominance also allows the United States to delay or shift any costs of global adjustment to other countries (Smart, 2018)."

4. Reflections on the theoretical model

The theoretical model in Figure 1 explaining the basis of dollar hegemony contains several insights and implications.

1. Power. The system is about power, and power is at the heart of dollar hegemony. There is simply no way of understanding dollar hegemony without reference to the role of power – economic power, military power, and international political power. A narrowly economic market forces approach to dollar hegemony misses those foundational elements.

2. Power is both an input and an output. The elements of the system are simultaneously both inputs and outputs. The system relies on power as an input, and it produces power as an output. Economic power and military power can be viewed as goals in themselves, enhancing national well-being and national pride. They are also inputs in the pursuit of those goals, which makes them both inputs and outputs. Dollar hegemony is an input that is useful in the pursuit of those goals, and it is produced by the triptych of power elements. However, it is not a goal in of itself (which is likely also true of international political power).

3. The state and currency hegemony. The system that produces dollar hegemony intrinsically involves the state. First, state power in its different forms is at the core of the system. Second, the dollar is a state money and its use and standing in the international financial system depend on

deficit.

the actions and standing of the state. There is simply no understanding dollar hegemony without recognition of the role of the state. Attempts to theorize currency hegemony (i.e., the currency cone) by reference to market forces alone are inevitably flawed.

4. Power and relative power. Currency hegemony is about power, and power is intrinsically a relative concept because the increased power of one party is implicitly a diminution of the power of rivals. Figure 1 focused on dollar hegemony and US power, the flipside of which is the power of other countries. That flipside is illustrated in Figure 6 which shows how dollar hegemony impacts the power of the rest of the world (ROW). The structure of the figure is the same as Figure 1, and the outer linkages have the same positive feedback loops. However, the interior feedback loops are different and are negatively signed. Thus, an increase in dollar hegemony decreases the power of the ROW, and an increase in the power of ROW decreases dollar hegemony.[8]

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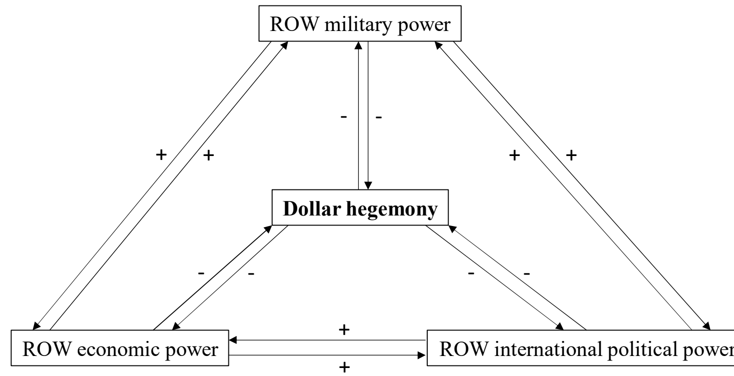
[8] Just as the model in Figure 1 can be represented by a system of simultaneous equations, so too can the model in Figure 6. The difference is dollar hegemony would enter the ROW economic, military, and international political power equations with a negative sign, and the power variables would also enter the dollar hegemony equation with a negative sign. The two systems can be combined to yield a seven-equation general equilibrium system in which the dollar hegemony equation includes both US and ROW power variables.

Figure 6. The relationship of the rest of the world's (ROW) power with dollar hegemony.
(+ and - = sign of impact effect)



The relationship between ROW's power and dollar hegemony has received insufficient attention. One immediate question is why do countries participate in the dollar hegemony system if it diminishes their power? One reason is there may still be significant other benefits. For instance, there may be significant economic gains from acquiring dollar denominated US financial assets, and invoicing in dollars may increase exports. Moreover, if countries are allied with the US, the cost of lost power will be greatly diminished. A second reason is there may be no alternative to the dollar system. In effect, the international monetary system is characterized by a form of transactions network natural monopoly. The issue of foreign participation is discussed further in Section 7 below.

The issues raised in Figure 6 also implicate the future of dollar hegemony and the international relations frictions that may arise. At its outset, many anticipated the euro would challenge dollar hegemony, yet the euro has punched persistently below its weight. That disappointing performance should be understood by reference to both the success of the US in

developing its power base and the failure of euro-zone governments to develop theirs. Consequently, the euro has suffered a relative power decline. That decline is the result of a trio of failures: failure to develop a sound monetary-fiscal framework for the euro-zone (see Herr, Priewe, and Watt (Eds.), 2017; Palley, 2011, 2017), failure to develop an independent and coherent pan-European military strategy, and the failure to develop an independent and coherent pan-European geo-political strategy.

Geo-political incoherence has now become especially significant. In the first years of the euro's existence (1999-2012) the dominant problem was the flawed monetary-fiscal framework. That was substantially patched in 2012 by the European Central Bank's (ECB) declaration of willingness to buy weak member country bonds and to push the ECB lending rate to zero. However, since then, the geo-political incoherence of euro-zone governments has become increasingly important. Thus, it can be argued the euro (and the European Union) suffers from over-expansion that has incorporated Central and Eastern European countries that are politically alien and have divergent political interests. Additionally, Europe has chosen to play camp follower to the US as regards geo-politics and conflict.[9] In accordance with the signing pattern in Figure 6, relative decline of European power across the spectrum has increased dollar hegemony.

Lastly, a relative power perspective is relevant for understanding the international relations frictions that may develop in response to challenges to dollar hegemony from Russia and China. Wang (2020) explores the impact of China on the international

[9] That has been visibly on display in the Ukraine conflict from which Europe has suffered enormously, whereas the US has been a net geo-political beneficiary. Europe has suffered huge economic costs in the form of energy supply disruption, inflation, and loss of the huge Russian export market for luxury and capital goods. Contrastingly, the US has gained new energy markets in Europe, ensnared Europe in even greater subservience to the US military, and created permanently heightened tensions with Russia that benefit the US geo-politically. Those factors are reflected in the 2022 surge in the value of the dollar and fall in the value of the euro.

financial system and introduces a distinction between threats to the liberal order and threats to US domination of the liberal order. The purpose is to provide a richer understanding regarding China's actions and question charges it is a threat to the liberal order. However, from the hegemon's perspective (i.e., the US perspective) the distinction is substantively moot as the US will be resistant to China's financial rise regardless of whether it challenges the liberal order. Power is relative so the US has an incentive to block China's financial rise. Furthermore, it also has an incentive to portray challenges to its dominance as challenges to the liberal order as a way of marshalling allied support against China.

The inherently relative power dimension of currency hegemony means dollar hegemony has latent rivalrous tendencies. Those rivalrous tendencies are most pronounced with countries that are politically distant from the US, but they are also present with US allies. Allies (e.g., Western Europe) may want to secure some of the economic benefits of currency hegemony for themselves and they may have their own geo-political identity and projects. They may also chafe under US hegemonic power, especially if it is abused.

5. Market forces and currency hierarchy

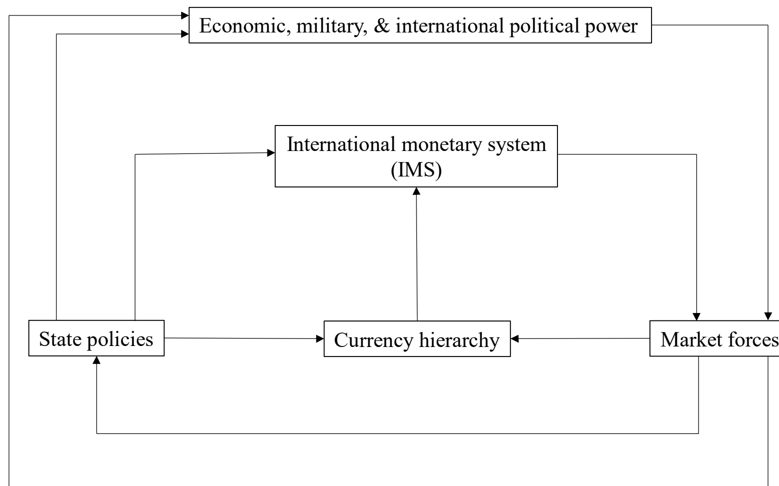
Market and state are both relevant for understanding currency hegemony and they play-off each other interactively. The framework in Figure 1 is static and identifies the role of state power in its various dimensions. This section introduces the role of market forces in the dollar hegemony process, which brings in traditional economic analysis.

Market forces are critical in sorting currencies and establishing the currency hierachy. Those forces work within the international monetary system (IMS). Metaphorically, the IMS is the international economy's financial plumbing, with the "dollar" pipes and liquidity reservoirs being far larger than the pipes and reservoirs of other currencies. Furthermore, the more that the

dollar pipes are used, the greater the incentive for others to use them as there are beneficial network externalities from currency usage.

The IMS has evolved over time in response to both changing market forces and state interventions, and the two interact. That interaction is illustrated in Figure 7 which consists of three concentric loops. The outer loop concerns the deep structural forces of relative economic, military, and international political power which were discussed in the previous section. That power configuration changes slowly and is the bedrock of dollar hegemony, and it is influenced by state policies. The configuration of power impacts market forces that feedback to impact the configuration of power. The middle loop has states' policies impacting the IMS, with states responding to market forces that may generate instability or persistent disequilibrium outcomes. The interior loop concerns the determination of the currency hierarchy.

Figure 7. The interaction between market forces and state policy.



The currency hierarchy is determined by both state policy and market forces. State policy manifests itself directly in the choice of composition of FX reserve holdings, and indirectly via

the influence of policies on the IMS and the international matrix of power. Market forces influence the currency hierarchy via the forces of currency competition. Those forces are analyzed by Cohen (1998, chapter 5, 92-118) who singles out the forces of currency internationalization and currency substitution. The former refers to the use of a currency in the international sphere, including trade invoicing and provision of international credit. The latter refers to the displacement of a currency in the domestic sphere. Market forces are therefore both international and domestic.

The notion of the IMS being the plumbing fits with the issues raised by Khana and Winecoff (2020) and McDowell (2020) who emphasize the power that comes with providing the transactions payments infrastructure. It is as if the US owns the plumbing through which global business is financed and transactions settled, and owning the plumbing makes the US (i.e., the dollar) indispensable and is a source of power. The plumbing constitutes a form of network, and owning it confers network power on the US as the US has the power to deny access to the plumbing.[10] With that power comes the political risk of abusing power via over-penalizing foreign banks that fall foul of US policy, which can induce a backlash to develop an alternative clearing mechanism that is outside of US jurisdiction (McDowell, 2020).

6. Applying the model: the history of dollar hegemony

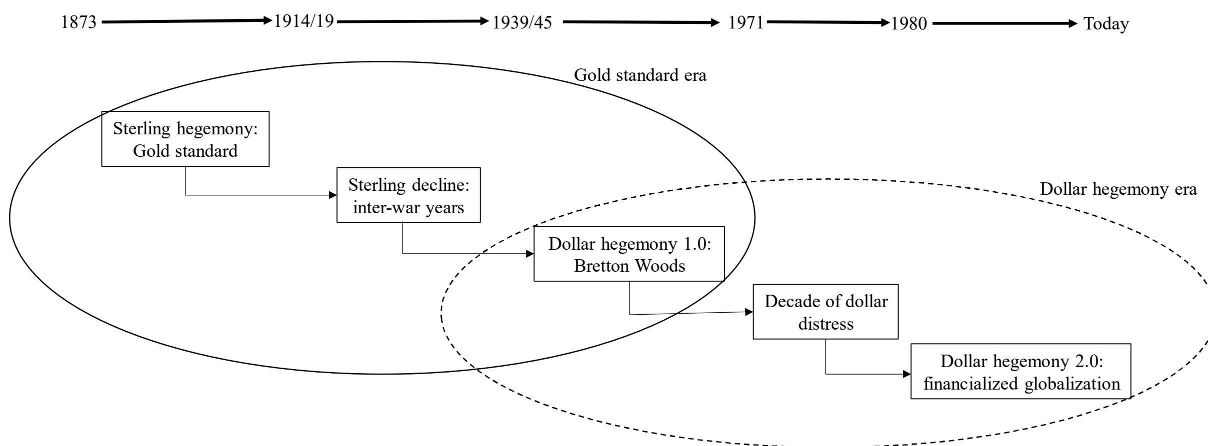
This section applies the above theoretical framework to analyze the history of dollar hegemony. That history reveals two types of changes. The first is change of hegemon. The second is changing economic operation of hegemony. As the global economy and the IMS have evolved, the economic operation of dollar hegemony has changed. Those changes in the global economy

[10] The key institution is the Clearing House Interbank Payments System (CHIPS) through which dollar transactions are cleared. That system is owned by private banks operating under US jurisdiction in the form of the Federal

and the IMS are the joint-product of market forces and state policy.

Figure 8 provides a stylized history of currency hegemony in the modern era, from 1873 through today. That history is divided into two overlapping eras consisting of the gold standard era (1873-1971) and the dollar hegemony era (1946-Today). The eras overlap because the post-War Bretton woods regime was a modified gold standard in which the dollar was the hegemonic currency.

Figure 8. Currency hegemony in the modern era, 1870 - Today.



Each era is divided into three sub-periods. The gold standard era consists of a golden age period of sterling hegemony (1873-1914), a transitional period of sterling decline (1914-1946), and the Bretton Woods period (1946-1971) which saw the arrival of dollar hegemony. The dollar hegemony era consists of the Bretton Woods period which was the first period of dollar hegemony, a decade of dollar distress (1971-1980) in which dollar hegemony was in doubt, and a second period of restored dollar hegemony associated with financial globalization that is on-

Reserve. SWIFT (Society for Worldwide Interbank Financial Transactions) is based in Belgium, and it wires money transfer instructions to banks but dollar transactions between banks clear through CHIPS.

going (1980-Today). Each sub-period has its own particularities which shed light on the workings and basis of dollar hegemony.

6.*1. Sterling hegemony, 1873-1914*

The starting point is the period of sterling hegemony under the classic gold standard in which sterling was convertible into gold by both governments and individuals. Starting with sterling hegemony provides contrast that helps understand dollar hegemony.

Though Britain had been on the gold standard before 1873, the modern era is dated as beginning then with the German empire's abandonment of its silver standard and adoption of a gold standard. Within the system, sterling was the hegemonic currency, and its hegemony is easily understandable in terms of the theoretical framework described in Figure 1.

As regards economic hegemony, Table 5 shows that in 1870 the UK was the world's largest economy, producing 9.1 percent of world GDP. Moreover, shares of world output are somewhat misleading as China was not integrated into the world economy, so the UK's effective weight was larger. As shown in Table 6, if the analysis is restricted to Western Europe and Western offshoots, the UK's share of total output rises to 20.8 percent.

Table 5. Shares of world GDP (percent of world total).
Source: Authors calculations based on Maddison, A., *The World Economy: A Millennial Perspective* , Development Centre Studies, OECD, Table B-20, p.263, 2001.
* = Author's calculation. Western offshoots = US, Canada, Australia, and New Zealand.

	1820	1870	1913	1950	1973	1998
UK	5.2	9.1	8.3	6.5	4.2	3.3
US	1.8	8.9	19.1	27.3	22.0	21.9
Western Europe & Western Offshoots*	25.5	43.8	55.2	56.9	51.0	45.7
World	100.0	100.0	100.0	100.0	100.0	100.0

Table 6. UK and US shares of GDP of Western Europe and Western Offshoots (percent of total).
Source: Authors calculations based on Maddison, A., *The World Economy: A Millennial Perspective* , Development Centre Studies, OECD, Table B-20, p.263, 2001.
* = Author's calculation. Western offshoots = US, Canada, Australia, and New Zealand.

	1820	1870	1913	1950	1973	1998
UK*	20.3	20.8	15.0	11.4	8.2	7.2
US*	7.1	20.3	34.6	48.0	43.1	47.9
Western Europe & Western Offshoots	100.0	100.0	100.0	100.0	100.0	100.0

Output shares also understate the UK's economic hegemony, which may be better reflected in export share. Table 7 shows the UK's share of world exports in 1870 was 24.3 percent. Furthermore, as shown in Table 8, its exports were a relatively far larger share of its GDP at 12.2 percent. Since UK exports were manufacturing goods, that implies the UK dominated global manufacturing which was the technologically dynamic sector of the time. In contrast, US exports were one-fifth of UK exports, despite the two economies being similar in total size. Moreover, US exports were significantly primary products, particularly cotton.

Table 7. Percent share of world exports.
Source: Author's calculations based on Maddison, A., *The World Economy: A Millennial Perspective* , Development Centre Studies, OECD, Tables F-2 and F-3, p.361-362, 2001.

	1870	1913	1950	1973	1998
UK	24.3	18.5	13.3	5.6	4.8
US	5.0	9.0	14.6	10.3	12.8
World	100.0	100.0	100.0	100.0	100.0

Table 8. Merchandise exports as percent of GDP in 1990 prices.
Source: Maddison, A., *The World Economy: A Millennial Perspective* , Development Centre Studies, OECD, Table F-5, p.363, 2001.

	1870	1913	1929	1950	1973	1998
UK	12.2	17.5	13.3	11.3	14.0	25.0
US	2.5	3.7	3.6	3.0	4.9	10.1
World	4.6	7.9	9.0	5.5	10.5	17.2

As regards military and diplomatic hegemony, this was the era of the *Pax Britannica* in which Britannia "ruled the waves" and the Royal Navy was globally supreme. Lastly, as regards international political hegemony, the era corresponded to the apogee of the British Empire which circled the globe, included 23 percent of global population in 1913, and covered 24 percent of the earth's total land area.[11] In sum, all the pieces making for currency hegemony were in place.

Reflection on the gold standard era of sterling hegemony is instructive. First, sterling hegemony rested on economic hegemony, but that was not simply a matter of economic size. It also reflected the UK's dominant position in global trade as reflected by export volumes and composition of exports (i.e., manufactured goods). Export dominance entailed sterling invoicing, which created demand for sterling. Second, during the gold standard era London was the world's dominant financial center, and by 1913 the UK accounted for approximately fifty percent of cumulative global capital investments (Darwin, 2013, p.185). As the largest global creditor,

[11] *British Empire*, https://en.wikipedia.org/wiki/British_Empiredom

debts were sterling denominated which created a demand for sterling to service those debts. Additionally, the depth of Britain's capital markets and the *Pax Britannica* fostered confidence in sterling, giving London an advantage in attracting gold which was necessary to back the system. That confidence also advantaged Britain regarding deposit interest rate settings needed to support its fiduciary issue (i.e., money issued in excess of gold reserves) by diminishing fears of a run from sterling to gold.

In sum, trade and finance interacted to jointly support sterling hegemony. Sterling hegemony was initially built on the UK's manufacturing and export dominance, which made Britain a global creditor and supported the growth of London as a financial center. Britain's creditor position and financial dominance then reinforced sterling hegemony. There is a tendency to explain currency hegemony in terms of economic hegemony, manufacturing competitiveness, and exports. Those factors were key to sterling hegemony, but Britain's financial dominance was also key.

6.2 Sterling decline: 1919-1939

The inter-war years correspond to the period of decline of sterling hegemony. The gold standard had been suspended with the onset of World War I in 1914, but the US returned to the Gold Standard in 1919 and the UK returned in 1925. That timing sequence speaks to the changed conditions wrought by World War I.

In terms of the currency hegemony theoretical framework in Figure 1, the UK was a diminished power in multiple ways. Economically, the war had reduced the UK's net wealth via borrowing from the US and the Soviet Union's default on UK loans to Tsarist Russia. That decline in wealth is shown in Table 9. The UK had also lost export markets during the war, and both the US and Japan had increased their manufacturing and export capabilities (Crafts, 2018,

p.120). Moreover, on the disastrous instruction of Chancellor of the Exchequer Winston Churchill, the UK returned to the gold standard at the pre-war gold exchange rate parity despite there having been significant price inflation since suspension of convertibility in 1914. That made UK exports less competitive, so that in the mid-1920s they were just 75 percent of their 1913 level (Crafts, 2018. p.120).

Table 9. UK overseas assets and liabilities, 1913 – 1951 (Billion pounds at current value at year end).
Source: R.C.O Matthews, C. H. Feinstein, and J.C. Odling-Smee, *British Economic Growth, 1856-1973*, Stanford: Stanford University Press, CA, Table 5.2, p.128 cited in M. Chick, *Changing Times: Economics, Policies, and Resource Allocation in Britain since 1951*, Oxford: Oxford University Press, 2020, p.308.

	Assets (billions of pounds)	**Liabilities (billions of pounds)**	**Net assets (billions of pounds)**	**Ratio of net assets to GDP**
1913	4.6	0.4	4.2	1.8
1924	6.8	1.6	5.2	1.3
1937	5.3	1.3	4.0	0.9
1951	6.9	7.6	-0.7	-0.5

Regarding international political power, the UK was confronted by a "Crisis of empire" (Tooze, 2014, Chap. 20). It was confronted by crisis in Ireland, Egypt, and India, with British imperial governance being challenged. Britain's military weakness was also exposed by Turkey in the 1922 conflict with Greece which Britain supported.

In short, the foundations of sterling's hegemonic standing had been substantially weakened. Furthermore, side-by-side with these adverse developments, the US had transformed from a debtor into a creditor, enhancing its relative power which is critical in understanding

currency hegemony. As shown by Eichengreen (2011, p.30-37), the US dollar was already in position to challenge sterling, having become the dominant form of FX reserves by 1925.

Despite those unfavorable conditions, sterling continued to be the hegemonic currency, albeit a limping hegemon. One reason was the US was far less engaged in international trade, as shown earlier in Tables 7 and 8. Consequently, sterling export invoicing still dominated dollar invoicing, maintaining the demand for sterling. A second reason was sterling still benefitted from the support of Britain's colonial governments and the Dominion countries (e.g., Australia, New Zealand, and South Africa) which kept their FX reserves in sterling out of loyalty to Britain (Eichengreen, 2011, p.37). A third reason was US domestic politics which were marked by isolationism. The US polity was not ready for international prime time, which meant the dollar was not ready for hegemony.

Moreover, the window of opportunity was short-lived and closed with the Wall Street crash of 1929 and the onset of the Great Depression which triggered a global turn to trade protectionism. In 1931 the UK went off the gold standard and suspended the right to convert, and in 1933 the US followed suit. The analytical point is the inter-war years show how currency hegemony has both economic and political foundations.

6.3 Dollar hegemony 1.0: the Bretton Woods era (1946 – 1971)

The next sub-period was the Bretton Woods era which is widely regarded as inaugurating the contemporary era. However, it was much more transitional, being a mix of old and new. The old was the continuation of an official monetary role for gold: the new was the inauguration of dollar hegemony.

As regards gold, central banks committed to convert government official balances into gold, but private sector agents had no such right. The official gold price was set at $35 per ounce,

reflecting that the dollar was now the standard. Differentiated convertibility rights immediately created a dual gold market in which the private market price slightly exceeded the official price.

Institutionally, the new features of Bretton Woods were provision of balance of payments adjustment assistance, the right to adjust exchange rates in response to persistent unsustainable deficits, and retention of financial capital controls. Those arrangements differentiated the Bretton Woods gold standard from the classical gold standard's *laissez-faire* position. Deficit countries were given adjustment assistance, the semi-fixed exchange rate system gave some flexibility but guarded against competitive devaluation, and capital movement was restricted.

Reflecting the transfer of power and the new political economic order of dollar hegemony, the Bretton Woods arrangements represented the US policy position and stopped short of Keynes' (UK position) Bancor proposal which sought to create an international clearing union in which surplus countries would have to help the adjustment process by importing more.[12]

6.3.1 Foundations of the new hegemony

In terms of the theoretical framework in Figure 1, after World War II everything was in place for the dollar to become hegemonic. Among Western countries, the US was the undisputed economic, military, and international political hegemon. In effect, it occupied the equivalent place Britain had occupied in 1873.

As regards economic power, the US had the largest and most productive economy. It already had the advantages of natural resource bounty, scale of domestic markets, and more modern factories owing to its more recent industrialization. To this were added the advantages of no war destruction and the free transfer of a huge amount of European scientific capital.[13]

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[12] FN: *Bancor*, https://en.wikipedia.org/wiki/Bancor

[13] Part of that transfer was the pre-war flight of scientists from Continental Europe, which was symbolized in the Manhattan Project that built the atom bomb using that acquired expertise. Another part of the transfer was the extraordinary (and little known) September 1940 Tizzard transfer. Fearing that Britain would be over-run by

Consequently, the US was the globally dominant manufacturing power and had a robust current account position. Those features were key to the establishment of dollar hegemony 1.0, just as they were to the establishment of sterling hegemony. They are necessary conditions for hegemony under a gold standard regime. However, as argued below in section 6.5, they are not necessary in a non-gold standard regime. Part of economists misunderstanding of contemporary dollar hegemony stems from continuing to think they are.

As regards finance, the US was the recipient of large amounts of Continental European emigree gold. Most importantly, it was the recipient of the UK's accumulated imperial treasure. In World War I the US profited by supplying the British and French militaries and it became a net creditor, but Britain also remained a large international creditor. World War II changed that, and Britain became a net debtor as shown in Table 9. Most importantly, the debt to the US was dollar denominated, placing the boot on the US foot as Britain now needed dollars to service its debts.[14]

As regards military power, the US ended World War II with a large modern military, a huge modern defense industry, and in possession of all the latest military technology, some of which Britain had freely transferred in 1940 as part of the Tizzard transfer (see footnote 14). In effect, the *Pax Americana* replaced the *Pax Britannica*. After the Spanish-American War of 1898 the US had begun the process of developing overseas military bases. World War II and the Cold War catapulted that process, with the US acquiring permanent massive military and naval

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Germany and its scientific knowledge captured, Winston Churchill authorized Sir Henry Tizzard to freely transfer to the US all the UK's top-secret novel military technology which included radar, sonar, the jet engine, the rocket engine, plastic explosives, gyroscopic gunsights, and self-sealing fuel tanks. After the war, the US continued to drain German scientific human capital and willingly forgave Nazi scientists, as exemplified by the rocket scientist Werner von Braun who was instrumental in NASA's 1960s space program.

[14] The US profited in World War I and it profited again in World War II in the period September 1939 - December 1941. The Roosevelt administration's famous Lend-Lease program charged top dollar prices for military supplies, hoovered Britain's gold reserves, and saddled Britain with dollar denominated debts.

garrisons in Japan, South Korea and Western Europe, and the number of permanent foreign deployments has only grown with time. That expansion symbolizes the US polity's rejection of isolationism which inhibited dollar hegemony in the inter-war years.

As regards international political power, here too World War II catapulted the US into global leadership. In 1947 the United Nations was headquartered New York. The International Monetary Fund and World Bank – the multilateral financial institutions (MFIs)– were formed in 1944 and established in Washington DC, with the US being given a dominant say and having veto power over amendments. The Inter-American Development Bank (IDB) was established in Washington DC in 1959, again with US veto power. The North Atlantic Treaty Organization (NATO) was established in 1949, with the US the undisputed helmsman. US higher education institutions (e.g., Harvard, Yale) became go-to destinations for foreign elites and powerful means for instilling US ideologies and loyalties to the US. Scholarships were provided under the Fulbright Program established in 1946, but the universities had sufficient charisma to attract student elites with or without assistance.

The MFIs were important (and continue to be) as most of their lending was done in dollars, thereby tying countries into the dollar network centered on Wall Street and requiring them to acquire dollars for repayment. The MFIs could also engage in politically motivated strategic lending to US political clients, turning on the loan spigot for friendly governments and turning it off for governments tagged as critical of the US. The multilateral organizations also won the loyalties of foreign elites by providing generously paid employment, with the IDB earning a special reputation as a revolving door placeholder for friendly Latin American politicians and their children.

In sum, all these organizations became powerful and enduring ways through which US international political influence could be disseminated and expanded. Lastly, the flip side of rising US international political power was declining British power caused by the two World Wars near bankrupting of Great Britain and accelerated disintegration of the British Empire. The power and standing of others are always part of the theory of currency hegemony.

6.3.2 From bliss to distress (1960 – 1971)

Explaining the history of the Bretton Woods era is not the purpose of this paper, but some explanation is needed. That is because the problems experienced generated US responses that became the novel basis of restored dollar hegemony. Parenthetically, those responses were all taken in the US interest, speaking to the strength of realist international relations theory.

The late 1940s and 1950s were a period of international bliss for the US economy. The US was the world's dominant manufacturing power and the world needed dollars - to purchase commodities, to purchases US capital goods to rebuild, and to service dollar debts. The problem was limited supply of dollars and dollar credit. The shortage was filled by Marshall Plan assistance and foreign aid, US overseas military spending, US multinational corporation foreign direct investment (FDI), and growing US imports.[15] In effect, the US was operating without an external financial constraint.

That slowly changed. On the financial side, the emergence of the euro-dollar market solved the problem of shortage of dollar credit. On the real side, Western Europe and Japan re-built, with significant focus on exporting aimed at solving their FX shortage problem. That challenged US manufacturing, increased exports to the US, moderated imports from the US,

[15] This was the era of massive FDI in Europe by US multinationals like GM, Ford, Chrysler, IBM, and Eastman Kodak. Greenfield investments stimulated European recovery and provided the dollars with which to buy US capital goods.

shifted the US into trade deficit, and shifted Europe and Japan into trade surplus. Additionally, the US adopted Keynesian policies that generated full employment, and by the mid-1960s it was also fighting a resource consuming war in Vietnam. Those conditions caused inflation and aggravated the trade deficit problem.

That matrix of conditions undermined confidence in the long-term value of the dollar, encouraging governments (particularly France) to convert dollars into gold, thereby threatening to deplete US gold holdings and raising further confidence concerns. As currency hegemon, the US could not devalue the dollar as that would encourage further gold conversions. The only solution was retreat from full employment and empire (cut foreign "aid" and foreign military spending) which the US was politically unwilling to do. Instead, in August 1971 the US suspended governments' right to convert dollars into gold and floated the dollar.

Three closing points. First, the Bretton Woods system was a gold standard, and the gold standard always imposes the discipline of convertibility on the hegemon which the US was unwilling to live by. Second, the US response was motivated by national self-interest. That is summed up in US Treasury Secretary John Connally's famous comment upon suspension of convertibility: "The dollar is our currency but it's your problem"." Third, the Eurodollar market contributed to undermining dollar hegemony 1.0 by solving the shortage of dollar credit. That reduced need for dollars supplied via US FDI, US government overseas spending, and the US current account. However, from a longer-term perspective, the Eurodollar market can be viewed as the beginning of dollar hegemony 2.0 as it established dollar denominated international lending in foreign financial markets. That has made foreign banks susceptible to bank runs that their national central banks cannot solve. Consequently, those central banks have become dependent on the Federal Reserve's willingness to supply emergency liquidity as happened in the

2008 financial crisis via the provision of central bank currency swaps, an arrangement which continues.

6.4 The decade of dollar distress: 1971 – 1980

The Bretton Woods system was the US's first engagement with dollar hegemony. It worked well until the US became a deficit country and subject to the disciplines of gold standard convertibility, at which stage it was abandoned.

The ensuing decade of the 1970s was a decade of dollar distress in which hegemony was in doubt. Ultimately, dollar hegemony was salvaged and reconstructed, with the new system of hegemony that emerged in the 1980s being significantly different regarding the way it operates and the outcomes it permits. Moreover, as also argued by Vernengo (2021), dollar hegemony 2.0 has proven even more dominant than dollar hegemony 1.0. Hudson (1972 [2021]) brilliantly intuited and anticipated the shape of the new system with his construct of "super-imperialism" which was informed by a Marxist finance capital perspective, awareness of the tacit imperial nature of the US international project, and awareness of the fact treasury bonds are promises to pay fiat money.

6.4.1 A sneak peak ahead

The differences in structure and outcome between dollar hegemony 1.0 and 2.0 are easily visible in the data. Table 10 shows that US GDP was 40 percent of global GDP in 1960, but only 22 percent in 2014. Figure 9 shows the US trade balance as a share of GDP for the period 1800-2018. Until the very end of the Bretton Woods period the US ran a trade surplus. Since then, it has run persistent large deficits that peaked at 6 per cent of GDP in 2006. That shows trade surplus is no longer a requirement for dollar hegemony. Figure 10 shows the US current account as a share of GDP for the period 1960-2022. Until near the very end of the Bretton Woods period

the US ran a current account surplus. Thereafter, it shifted into growing deficits, which peaked at 6 percent of GDP in 2006. That shows current account surpluses are no longer necessary for dollar hegemony.[16]

Table 10. US GDP as percent of global GDP.
Source: Patton, M. (2016), 'US share in the global economy declines almost fifty percent,' Forbes.com https://www.forbes.com/sites/mikepatton/2016/02/29/u-s-role-in-global-economy-declines-nearly-50/?sh=158d5da15e9e

1960	1970	1980	1990	2000	2010	2014
40%	36	26	27	31	23	22

Figure 9. US goods trade balance as percent of GDP, 1800-2018.
Source: Reinbold, B. and Wen, Y. (2019), "Historical US Trade Deficits", *Economic Synopses*, No. 13, Federal Reserve Bank of St. Louis, https://research.stlouisfed.org/publications/economic-synopses/2019/05/17/historical-u-s-trade-deficits

[16] One of the surprising features to contemporary eyes is how small external deficits were as a percent of GDP, yet they were still able to destabilize the system. That reflects two features. First, the era was pre-Neoliberal globalization so that trade was a much smaller share of GDP (see Palley, 2018). Second, the gold standard was unaccommodating of imbalances owing to the discipline of convertibility.

Figure 10. US total current account balance as percent of GDP, 1960-2022.
Grey bars are periods of recession. Source: FRED, St. Louis Federal Reserve Bank https://fred.stlouisfed.org/series/USAB6BLTT02STSAQ

The above data show the diminished significance of relative size of GDP and the external balance (trade and current account) for currency hegemony. That distinguishes dollar hegemony 2.0 from both dollar hegemony 1.0 and sterling hegemony. Previously impossible trade and current account deficits have become the norm. That became apparent almost immediately after the 1971 suspension of convertibility. There was an immediate dollar depreciation that briefly improved US external balance position, and thereafter the shift to persistent large external deficits set in.

The key to the new pattern is absence of convertibility combined with increased demand for US assets. Bretton Woods dollar hegemony was built on US industrial might and the ability to run trade surpluses. Neoliberal dollar hegemony is built on the standing of the US as the center of global capitalism. The failure of mainstream economists to appreciate this tectonic shift is why they have persistently misinterpreted the US trade deficit as a harbinger of dollar collapse (Bergsten, 1987, 2009a, 2009b; Roubini and Setser, 2005).

Dollar hegemony has been restored and strengthened despite the decline in conventional measures of US economic power, indicating conventional economic power has become less significant. Instead, dollar hegemony 2.0 rests on the elevation of financial market power, combined with military and international political power which continued to accumulate in the Bretton Woods era.

As argued below, dollar hegemony 2.0 should be understood as part of Neoliberalism which is a political economic ideology that has been adopted by national elites globally and has informed the design of the global economic system. Viewed in that light, dollar hegemony 2.0 is the capstone of the Neoliberal system, an integral component of the system rather than a separate phenomenon.

6.4.2 The remaking of dollar hegemony

The 1970s saw implementation of piecemeal changes that eventually aggregated into dollar hegemony 2.0. The first decisive change was suspension of dollar convertibility which forced foreign central banks into holding US Treasury bonds, creating a dollar Treasury bill standard in place of gold (Hudson, 1972 [2021]). In that fashion, foreign surplus economies implicitly financed US overseas imperial activity. Meanwhile, US Treasury bills were simply promises to repay dollars which are issued by the Federal Reserve Bank.

That is the key feature of dollar hegemony 2.0. The US issues debt in its own currency on which it cannot default unless it chooses to.[17] However, that left unresolved willingness to hold those bonds and the exchange rate. Unwillingness to hold bonds would adversely affect interest rates, while unwillingness to hold dollars would depreciate the dollar and lower the dollar's

[17] Britain failed to do that. The gold standard bound it to convertibility, and the US lent in dollars in World War II.

overseas purchasing power. Dollar hegemony 2.0 has closed those holes by locking the world economy into the dollar.

A second critical development was the US - Saudi accord of 1974 (see Gertzman, *New York Times*, June 9, 1974) whereby Saudi Arabia agreed to sell oil only in dollars in exchange for US military protection. That agreement reflected the role of US military and international political power, and it sent a global message. In the immediate moment, it plugged the financial consequences of OPEC's 1970s oil price increases. Longer-term, it rendered the huge global energy and commodity sector a dollarized sector, thereby locking both producers and consumers of energy and commodities into the dollar financial network.[18]

A third related development was the petrodollar recycling system that developed on the back of the US - Saudi accord. That system had petrodollars deposited in New York, and then lent to other countries (particularly in Latin America) which needed dollar financing to cover the higher cost of oil. Though there were subsequent Latin American defaults (about which more below), the recycling system created dollar debts that required dollar income to service and deepened engagement in the dollar financial network.

A fourth critical development concerns European foreign exchange controls, which were progressively abolished beginning in the late 1970s. The process began with the UK's Thatcher government abolishing controls in June 1979. France and Italy dismantled their exchange controls in the second half of the 1980s. The importance of that abolition is it created a huge demand for US financial assets among private sector agents who had been substantially restricted

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[18] Henry Kissinger, the architect of the agreement, described it as: "…a milestone in our relations with Saudi Arabia and the Arab countries in general (*New York Times*, June 9, 1974)." The only two Arab leaders who have threatened this *status quo* are Iraq's President Saddam Hussein and Libya's President Muammar Gaddafi, and both were deposed and executed by the US. As of 2022, Russia's President Putin has now challenged the *status quo* by demanding payment in rubles for Russian oil and gas.

from accumulating foreign currency denominated assets for a generation.[19] That flags two important points. First, it shows how dollar hegemony also depends on the actions of other countries, and not just the actions and policies of the US. Second, Thatcher's and European embrace of unrestricted financial capital mobility was an ideological turn driven by the triumph of Neoliberal thinking, with its mantra of "market forces". The Neoliberal revolution in economic policy was substantially spawned in the US, led by the Chicago School of economics. That speaks to the importance of the international political hegemony of the US.[20]

6.5 Dollar hegemony 2.0: the dollar restored (1980 – Today)

At the end of the 1970s the dollar was still distressed. The 1980s and 1990s saw the restoration of dollar hegemony, with Treasury Secretary Rubin's (1995-1999) "strong dollar" policy marking the completion of that process.

The first step was the high interest rate policy of Federal Reserve Chairman Paul Volker (actually begun in late 1979). High interest rates constitute classic monetary policy for strengthening a currency by increasing the return to holding the currency, but now they were applied to transform the economy. The goal was to squeeze inflation out of the economy and intimidate organized labor via high unemployment. Moreover, the message was zero tolerance of inflation was here to stay.

The second step, which is intimately related to the first, was the remaking of the US economy in a Neoliberal image. That remaking and image are reflected in the phenomenon of

[19] Helleiner (1994) also emphasizes the importance of the elimination of capital controls in the making of financial globalization, explaining it in terms of cross-country competitive deregulation. The focus and argument are slightly different here, being the making of dollar hegemony. There is also the separate additional question of the impacts of abolishing capital controls on the UK and Europe.

[20] Leading figures at Chicago were Milton Friedman and George Stigler. Friedman had an especially strong influence on Thatcher via the Institute for Economic Affairs (IEA) which is the British analog of the American Enterprise Institute. The specific influence of Friedman was visible in Thatcher's embrace of Monetarism. The influence of Neoliberalism was visible in her embrace of privatization, small government, and anti-trade unionism.

financialization which is a formulation of Neoliberalism that favors finance capital (Hudson, 2021; Palley, 2007, 2021). The key feature of Neoliberal financialization has been redistribution of income from labor to capital, plus a shift in the composition of capital income toward finance capital.

Dollar hegemony requires the US be the center of global capitalism. Neoliberal financialization contributed to that by hugely increasing the attractiveness of US capital in terms of profit rate, low taxation, business friendly corporate governance, and labor unfriendly economic policy. Asset price inflation supported by monetary policy is another component of the US Neoliberal financialization model and it has helped draw financial capital to the US, thereby bolstering dollar hegemony.[21]

The above domestic US agenda was complemented by a Neoliberal international economic agenda. At the center of the international agenda has been globalization which is marked by increased trade, increased FDI, and the creation of a new disarticulated global production network. Globalization has complemented the domestic Neoliberal agenda, helping shift the distribution of income by reducing the wage share. It did so by putting manufacturing in the crosshairs of global labor competition, and in doing so it also destroyed unions which were a political opponent of Neoliberalism (Palley, 2018).

That globalization effect was enhanced by Treasury Secretary Rubin's "strong dollar" policy which appreciated the exchange rate and put additional downward pressure on

[21] The above argument re financialization contrasts with Vernengo (2021) who argues capital interests brought down Bretton Woods to bring down Keynesianism. The view in this paper is different. Bretton Woods collapsed owing to the unacceptable restraint on US hegemony posed by gold convertibility. Ironically, Bretton Woods inhibited the US's ability to pursue Keynesian policy. Capital controls persisted long after the 1971 collapse of Bretton Woods and were only abolished with the triumph of Neoliberalism. That said, the bringing down of Keynesianism (writ large as social democratic macroeconomic policy) was necessary for the restoration of dollar hegemony because post-war Keynesianism tended to put labor interests ahead of those of capital.

manufacturing wages. The strong dollar policy also benefitted various capital interests. Wall Street benefitted as the strong dollar increased its capacity to buy foreign assets and increased the need for US trade deficit financing which was recycled back into US financial markets. US MNCs benefitted because it lowered the dollar cost of foreign sourcing, thereby increasing margins on their US sales of foreign sourced production. And Big Box retailers like Walmart benefitted because it lowered the costs of manufactured imports which those retailers sell.

In addition to increasing the profitability of US capital, globalization has increased the need for and standing of the dollar. With global economic activity substantially executed in dollars, globalization has increased the need for dollar financing for trade and FDI. That has increased seignorage and the "golden crumb" from dollar denominated commercial lending. It has also increased US geo-political power by increasing necessity of access to the US controlled global financial system plumbing.

Furthermore, global Neoliberalism has increased inequality in countries across the board. Increased inequality tends to increase the demand for wealth as the rich save more. That has been good for US assets, and by extension the dollar, as the US has been re-engineered to be the place to hold capital. For wealthy foreigners, the US has security of property rights and US citizens are strongly pro-property rights; taxation is friendly toward capital; and as shown by the Pandora Papers, the US is friendly to inflows of ill-gotten assets with state law (e.g., Delaware) permitting shell companies that provide ownership annonymity.

The globalization agenda has been pushed using the US's international political power, exercised through the multilateral institutions. As noted earlier, Latin American countries incurred large dollar debts in the 1970s, but Mexico defaulted in 1982, triggering a shutdown of private lending to the region. The US organized a bailout of Mexico and the IMF stepped in to

provide credit to Latin America, but the condition was Latin America accept the Neoliberal program widely referred to as the "Washington Consensus". That program opened Latin American economies to US investors while removing capital controls, thereby further integrating Latin America into the dollar sphere. The episode showcases US hegemony. It also shows the role of local elites which, in Latin America, embraced the program as a way of looking after their interests. That underscores how dollar hegemony is a product of both US power and the choices of other countries.[22]

Throughout the 1980s and 1990s the IMF was a critical institutional force driving globalization and integration into dollar dominated finance. This was done via "conditionality" of its balance of payments assistance which required countries adopt the the "Washington Consensus" economic policy program, and through its dominance of regional policy discourse. The IMF has acted as a mix of bailout provider, credit enforcement agency, loan pusher, and promoter of export-led growth that makes countries dependent on US market (about which more below).[23]

Another soft power-driven aspect of the international agenda was regional and international trade agreements - the North American Free Trade Agreement (NAFTA) and the GATT Uruguay round that established the World Trade Organization (WTO). Those agreements enabled the new international production system of offshore outsourcing and global supply chains. They also established a global regime of international property rights (IPR). Both have greatly increased US multinational corporation profits, which has increased the value and attractiveness of US capital (Schwartz, 2019). Enhanced IPR have especially benefitted the US

[22] The US and IMF also sought to implement a similar program in East Asia after the East Asian financial crisis of 1997, but that attempt was significantly rebuffed by East Asian countries.

as it is the world's leader in ownership and production of intellectual property (Soskice, 2022). Additionally, the new global production arrangements have increased dollar engagement to the extent the global supply chain is invoiced in dollars.

Lastly, in contrast to the Bretton woods era, the phenomenon of emerging market export-led growth has been transformed to support dollar hegemony. In the Bretton Woods era, German export-led growth threatened the dollar by creating trade deficits. In the 1970s, Japanese export-led growth created trade deficits and threatened US manufacturing. In the Neoliberal era, those adverse effects have been sidestepped by abandonment of convertibility and abandonment of domestic manufacturing in favor of global sourcing.

Palley (2006) describes the new relationship between export-led growth and dollar hegemony as constituting a Keynesian "buyer of last resort" theory of currency hegemony.[24] The logic is as follows. Export-led growth economies are short of demand and rely on the US market to provide demand. They also rely on an undervalued real exchange rate to ensure competitiveness. Consequently, they must hold their trade surpluses in dollars or else their currency will appreciate (and the dollar depreciate), which increases demand for dollars. That situation is exemplified by China, and the logic also applies to Germany and Japan which have been unable to abandon their export-led growth model.

The net result is export-led growth has been transformed into a system that is supportive of dollar hegemony. It provides the US with real resources (i.e., imports); it increases the demand for dollars to conduct international trade; it strengthens the demand for US assets; it

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[23] A recent egregious example of such behavior was the 2018 record-sized loan to the center-right Macri government of Argentina, made prior to the election at the pushing of the US government which sought to help President Macri win the election.

[24] Schwartz (2019, p.499-503) has independently made a similar argument, also emphasizing how export-led growth integrates the financial sectors of foreign countries into the US financial sector.

bolsters Wall Strret financial interests by promoting a strong dollar; and it integrates the financial sectors of foreign countries into the US financial sector via the process of recycling trade surpluses.

In sum, abandonment of dollar convertibility, the petrodollar/commodity pricing system, foreign country abandonment of capital controls, the remaking of the US economy in a Neoliberal image, the inauguration of Neoliberal globalization,and the global spread of export-led growth combined to create a new economic matrix that has supported dollar hegemony 2.0. The deep foundations of dollar hegemony 2.0 remain the same as those of dollar hegemony 1.0 (and sterling hegemony before that): economic power, military power, and international political power. However, the way the two systems look and operate is completely different as they rest on entirely different economic models.

6.6 Dollar hegemony 2.0: ideologically coordinated but not planned

It is tempting to view dollar hegemony 2.0 as a planned system, but it is not. Instead, it is the outcome of an evolving US response to challenges and constraints, with that response being guided by the political economic ideology of Neoliberalism. That ideology has guided and coordinated the interests of capital, making it look as if dollar hegemony 2.0 were planned.

Neoliberalism stands behind dollar hegemony 2.0, and class interest stands behind Neoliberalism. That means class interest stands behind dollar hegemony 2.0. This aspect of dollar hegemony is strangely absent in the IPE literature. The US establishment claims dollar hegemony is in the national interest (see Smart, 2018), but the above argument suggests it is in capital's interest.[25]

[25] National interest is a substantially empty construct absent reference to who defines national interest. Elites always have an incentive to claim their policy actions are in the national interest as that provides a cloak which works to their advantage.

The significance of Neoliberal ideology points to the critical role of mainstream economics. As argued in Palley (2012, Chap. 11), Neoliberalism is deeply informed by mainstream economics which provides the basis for its core claims about the efficiency of market economies. Beyond that, economics has provided the policy specifics of Neoliberalism. Capital interests have been guided in their thinking by economics. Economics has informed, helped coordinate, and rationalized capital's choices. Those choices have then been politically sold using the libertarian rhetoric of Neoliberalism.

Though dollar hegemony 2.0 has ended up being the destination, it was not foreseen. That is illustrated by the fact mainstream economists have continued to perceive the dollar through the lens of manufacturing and trade, which was the lens of the gold standard and dollar hegemony 1.0. Consequently, many have persistently thought large US trade and current account deficits would trigger a crisis. That view is exemplified by Bergsten (1987, 2009a, 2009b) who was an influential advocate and promoter of the Neoliberal globalization policies that have enabled dollar hegemony 2.0, yet who also worried about a dollar collapse for thirty-five years. Nouriel Roubini (Roubini and Setser, 2005) famously predicted a dollar crash would trigger a global financial crisis. The dollar crash never happened but the global financial crisis (2008) did. The notion of dollar collapse has also been embraced by progressives who argued the hollowing out of manufacturing created trade deficits that posed a financial threat (Faux, 2002).

7. The global embrace of dollar hegemony

Contemporary dollar hegemony is a global financial system organized on the US dollar, the fulcrum of which is US financial markets operating within the context of a US and global economy shaped by Neoliberalism. The previous section traced the sequence of major developments that have contributed to making dollar hegemony.

In telling that story there is a danger of over-looking the role of other countries. Dollar hegemony rests on US hegemony, which includes military might. Undoubtedly, the US has used that might, especially in Latin America – occasionally directly (as in Chile in 1973) and often indirectly by putting its heavy thumb on the democratic scale in favor of friendly governments. However, dollar hegemony has not been imposed by force. Instead, it has been embraced willingly through the interactive combination of market forces and support of foreign elites.

7.1 Foreign elites and the voluntary embrace of dollar hegemony

In 1979 the UK abolished capital controls, and France and Italy abandoned them in the 1980s. As noted earlier, that abolition was an important step in the making of dollar hegemony, but it was done voluntarily by foreign governments. Understanding that abolition begins with recognition that the Thatcher government was ultra-Neoliberal. That points to how foreign embrace of dollar hegemony was driven by elites who viewed the Neoliberal model as advancing their class interests.

One benefit was the ability to invest in US financial assets. A second benefit was the removal of capital controls enables financial markets to pressure policy via the threat of exit, thereby enabling a cross-country competitive dynamic for deregulation and pro-business policies. Much attention has been paid to how globalization has promoted a race to the bottom in labor standards, with emerging market economies pressuring wages in industrialized economies. However, there is also a less talked about symmetric capital-based race to bottom that operates via financial markets. The ability to exit is key, which gives elites an incentive to implement capital mobility.[26] Just as the US capitalist class has benefitted from adoption of Neoliberalism,

[26] Regarding taxation, there is some evidence the US has led race to the bottom, acting as a Stackelberg leader which has cut its own corporate tax rates and led other countries down that path (Kumar and Quinn, 2012).

so too have foreign country capitalist classes. Though Neoliberalism has entailed dollar hegemony, foreign elites have still gained from it.

The embrace of dollar hegemony was a political process, and that process was facilitated by ideological developments. That leads back to the multiple channels of US soft power. Particularly important is the capture of economics. As noted earlier (see footnote 21) Mrs. Thatcher was an early believer in Milton Friedman's Chicago School of Economics. That view is now widely adopted by the European and global economics profession, albeit caveated by varying degrees of market failure. The Chicago view promotes free trade and capital movement which are necessary building blocks of dollar hegemony. Consequently, economists have both inculcated and rationalized foreign elite support, putting the idea there if it was not already there and strongly justifying it if it was.

The IMF was especially influential in pushing the embrace of dollar hegemony in Latin America, both via simple advocacy and by conditioning balance of payments assistance on adoption of the Washington Consensus program. Belief in the merits of financial capital mobility is an enduring tenet of the IMF, though it is now verbally hedged to inoculate versus the political backlash against Neoliberal globalization. The creed is captured in a 1997 official speech by IMF Managing Director Stanley Fischer, who was the US appointee and a liberal former professor of macroeconomics at MIT. The policy goal was to amend the IMF's Articles of Association to make unrestricted financial capital mobility the IMF's baseline and a condition of membership. To that end, Fischer (1997) argues:

> "Put abstractly, free capital movements facilitate a more efficient allocation of global savings, and help channel resources into their most productive uses, thus increasing growth and welfare. From the individual country's perspective, the benefits take the form of increases in both the potential pool of investible funds, and the access of domestic residents to foreign capital markets. From the viewpoint of the international economy, open capital accounts support the

> multilateral trading system by broadening the channels through which developed and developing countries alike can finance trade and investment and attain higher levels of income. International capital flows have expanded the opportunities for portfolio diversification, and thereby provided investors with the potential to achieve higher risk-adjusted rates of return. And just as current account (trade) liberalization promotes growth by increasing access to sophisticated technology, and export competition has improved domestic technology, so too capital account liberalization can increase the efficiency of the domestic financial system [paragraph 11]."

Though the attempt to change the IMF's Articles failed, it speaks to economists' and the IMF's thinking.

7.2 Currency competition and the voluntary embrace of dollar hegemony

A second driver of foreign embrace of dollar hegemony is market forces associated with currency competition. The forces of currency competition can be divided into push and pull factors, though to an extent they are mirrors of each other. Push factors are domestic, and they push foreign elites to engage with the dollar. Pull factors are external and pull foreign elites to engage with the dollar.

Push and pull factors operate in every economy, but they are most easily illustrated by reference to developing economies. The classic push factor is domestic monetary failure associated with high inflation. Under such conditions, domestic money loses its store of value and invoicing capability. In the extreme there can be dollarization whereby the domestic currency is abandoned for the dollar. Another reason for shifting to the dollar and dollar denominated assets is domestic tax evasion. That can encourage invoicing in dollars, with payment into foreign bank accounts and only partial repatriation. Additionally, developing countries often have high income inequality and are subject to political instability. That can implicate the security of property rights and give reason to park wealth outside a country.

As regards pull factors, developing countries have thin asset markets with few assets for saving and holding wealth, so wealtholders are incentivized to seek offshore stores of wealth. That practice is also often motivated by tax evasion which is a push factor. Broadly speaking, the US has a superior macroeconomic environment measured by inflation, exchange rate volatility, and growth rate volatility. It also has thick liquid financial markets that offer a wide array of assets with varying risk-return properties, and it is favorably disposed to property. Those characteristics make it attractive for foreign elites to hold US financial assets, which pulls money into the US.

The US is also a major tax haven and facilitates hiding and laundering wealth as revealed by the Pandora Papers (Vittori, 2021). Delaware, Nevada, and South Dakota all have corporate secrecy provisions that shelter money, which pulls wealth out of other countries.[27]

The set of push and pull factors connect with the economic logic embedded in the currency cone which was discussed earlier. First, the greater depth and the favorable political economic characteristics (i.e., favorable to capital) of US financial markets explains the logic of the pull of the dollar versus weak and junk currencies. Moreover, migration from weak and junk currencies further strengthens the advantage of the dollar, creating a form of cumulative causation.

Second, attention has focused on the pull out of weak and junk currencies, but the pull also applies to strong and minor major currencies. That is evident in shrinking small country stock markets as companies transfer listings to larger markets and domestic investors diversify internationally. The process is exacerbated by the financial advantage conferred on US

[27] Worse yet, it facilitates illegal economic activity, tax evasion, and anti-social elite financial behavior in the global economy.

companies by dollar hegemony. Thus, US corporations receive superior valuations and have easier access to credit, enabling them to buy foreign rivals. Those rivals are then de-listed from stock markets and their headquarters transferred.

Third, the above cumulative causation logic of dollar hegemony suggests it should be of policy concern to other countries. A national currency and national financial markets confer major economic benefits. A national currency yields seignorage for public finances and enables government to manage economic activity. National financial markets may facilitate entrepreneurship, capital accumulation, and households' ability to provision for the future. Those features are good for macroeconomic stability, growth, and societal well-being. The cumulative causation logic of dollar hegemony puts those benefits at risk by undermining the national currency and national financial markets, which may warrant a protective policy response. Financial competition may be like cultural competion, endogenously producing an increasingly tilted playing field by systematically increasing the advantages of the advantaged.

8. Conclusion

This paper has revisited dollar hegemony, emphasizing it is a fundamentally political economic phenomenon. Dollar hegemony rests on the economic, military, and international political power of the US and is manifested through market forces. The paper argued there have been two eras of dollar hegemony which were marked by different models. Dollar hegemony 1.0 corresponded to the Bretton Woods era (1946-1971). Dollar hegemony 2.0 corresponds to the Neoliberal era (1980-Today). The 1970s were an in-between decade of dollar distress during which dollar hegemony was reseeded. The deep foundation of both versions is US power, but the two versions have completely different economic operating systems. Dollar hegemony 1.0 rested on the trade and manufacturing dominance of the US after World War II. Dollar hegemony 2.0 rests on the

Neoliberal reconstruction of the US and global economies which have made the US the center of global capitalism and the most attractive place to hold capital. It is a financial model and intrinsically connected to Neoliberalism.

Consideration of dollar hegemony leads to two further questions. One is whether there is a better way of organizing the world monetary order, which is associated with debate about the possibility of a new Bretton Woods (see Bibow, 2022; Priewe, 2022). The other is what is the future of dollar hegemony?

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