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US Dollar Dominance in International Trade and the Impact of Trump's Policies

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Abstract: This paper delves into the status of the US dollar as a world reserve currency and its profound impact on China's economy. It emphasizes the significance of capital account convertibility for governments and advocates the necessity for reform in the international monetary system. The study sheds light on China's remarkable economic growth and its reliance on the US dollar, while also exploring the emergence of an alternative currency basket featuring the Chinese yuan (RMB). With the gradual depreciation of the US dollar on the horizon, the potential consequences for China's economy are thoroughly examined. Additionally, the paper addresses the risks associated with de-dollarization and the potential flight of USD-denominated debt to alternative assets like gold. A detailed analysis of how Trump's economic policies, especially the trade war with China, have impacted the global role of the US dollar is presented. Furthermore, the paper provides a comprehensive historical review of the international monetary system, spanning from the gold standard to the Bretton Woods system and the Jamaican system. It critically discusses the flaws and instability inherent in the current system, including issues related to currency over-issuance and the multi-currency reserve system. In conclusion, the paper examines the policy signals of the Federal Reserve and the US Treasury, along with the ramifications of Trump's economic policies on the US dollar and the global economy. The findings underscore the urgent need for measures to address the challenges posed by the current monetary system and its potential impact on China's economy. The study advocates for a proactive approach to international monetary system reform to ensure economic stability, promote balanced global economic growth, and address the complexities arising from the dominant status of the US dollar as a world reserve currency.

Keywords: Trade, Dollar, Convertibility, CNY-USD exchange rate, Currency basket, De-dollarization, Globalization.

Introduction

Governments often rely on foreign capital to mitigate the impact of the US dollar on their economies. Capital account convertibility is of vital importance to each country's government, leading them to prioritize financial management and advocate for reforms in the international monetary system. China, in particular, has experienced remarkable economic growth, becoming a key driver of global economic expansion. As such, changes in the US dollar exchange rate significantly affect China's economic development, influencing import and export dynamics, price levels, and employment rates.

Despite the US dollar's substantial dominance, an alternative RMB currency basket has begun to take shape. However, the gradual depreciation of the US dollar is expected to have the most profound impact on China's economy (Molnár et al., 2023; Molnár & Csiszárík-Kocsir, 2022, 2023). The fluctuation of the US dollar exchange rate remains a crucial external factor that influences China's economic performance.

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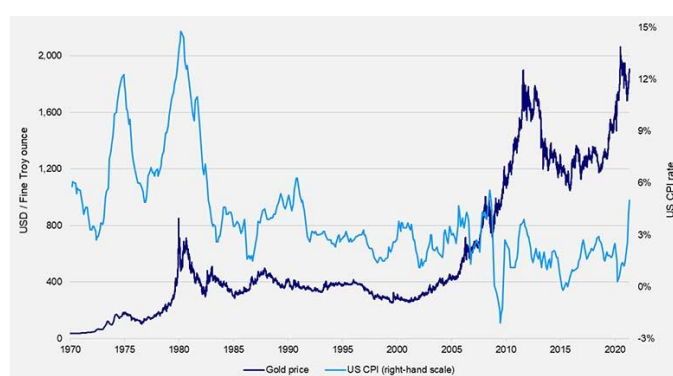
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In this paper, we delve into the status of the US dollar as a world reserve currency, carefully examining the risks associated with de-dollarization and the potential flight of USD-denominated debt towards assets like gold and other alternatives. We also analyze how Trump's economic policies, particularly the trade war with China and associated rhetoric, have influenced the global role of the US dollar. By addressing these critical aspects, our study aims to provide a comprehensive understanding of the intricate relationship between the US dollar and China's economy. This analysis contributes to the ongoing dialogue surrounding the international monetary system and underscores the significance of implementing policies that foster economic stability and sustainable growth in the face of currency fluctuations and global economic uncertainties.

Literature Review

Before the 18th century, precious metals like gold and silver were mainly used as currencies. The monetary systems of western countries have experienced a transition period from the silver standard to the gold and silver complex standard. Generally, the gold standard system refers to the gold coin standard system (Gold, W. 1981), 1. As seen in figure 1, gold is an excellent hedge against inflation. (Csapó et al.,2018) (Löblin et al.,2017)



Data: Bloomberg, to 31 May 2021.

Figure 1. Gold price vs CPI. Source: (Funds, 2019)

Historically, the gold bullion standard and the gold exchange standard system have appeared. The significance of the gold standard is to use gold to determine the value of money. Gold is both an internal payment currency and an external payment currency (Garai-Fodor et al.,2022; Fodor,2022). In order to save the utilization of gold, Italy decided to establish the gold exchange standard system in 1922. Within this system, domestic bank vouchers are only circulated in the country. Bank vouchers cannot be exchanged for gold. They can only be exchanged for gold bullion or the currency of a gold standard country (Eichengreen, 1990). In addition to gold, international reserves have a certain proportion of foreign exchange. Foreign exchange can be exchanged abroad. Countries with a gold exchange standard need to maintain a fixed exchange rate with the currency of another country adopting a gold bullion or gold coin standard system and maintain the stability of the value of their currency by buying and selling foreign exchange without restrictions (Nurske, 2005; Garai-Fodor et al., 2023).

Under the gold exchange standard system, due to the consideration of their own interests, countries have devalued their currencies and caused confusion in the international economic order (Grant, 2014). From 1929 to 1933, the world economy experienced a Great Depression, accompanied by deflation and overcapacity, which destroyed the gold bullion and gold exchange standards in western countries (Borazan, 2023; Baranyai et al., 2023).

With the widespread implementation of the currency circulation system in western countries, the crisis of the currency credit system has continued to deepen, and a unified international currency system cannot be established, and currency groups have been successively established. All these developments have raised awareness of the importance of financial literacy (Csiszárík-Kocsir et al., 2013, 2016a, 2016b, 2021; Csiszárík-Kocsir & Varga, 2017; Garai-Fodor et al., 2016; Garai-Fodor &Csiszárík-Kocsir, 2018a, 2018b; Baranyi et al., 2022).

A currency group is centered on the currency of a major country and uses this currency as its internal reserve currency for liquidation. Intra-group foreign exchange payments and free capital flow, but strict control on the receipt and payment and settlement outside the group, gold as an international settlement means, to play its

world currency functions. (Wandschneider, 2008; Garai-Fodor,2022;Garai-Fodor et al.,2022) In 1933, the United States established the dollar group, and in 1939 it developed into a dollar zone. The national currencies in the US dollar zone are pegged to the US dollar, and a fixed exchange rate system is implemented (Strange, 1972, p.199). Foreign exchange control is not implemented in the region, and the foreign exchange and US dollars of member countries are basically in the United States.(Foldi,2015a, 2015b) The British Pound District was also established in the same year, mainly including the United Kingdom and the Commonwealth. The objective environment at that time created a lack of a unified currency system in the international community.

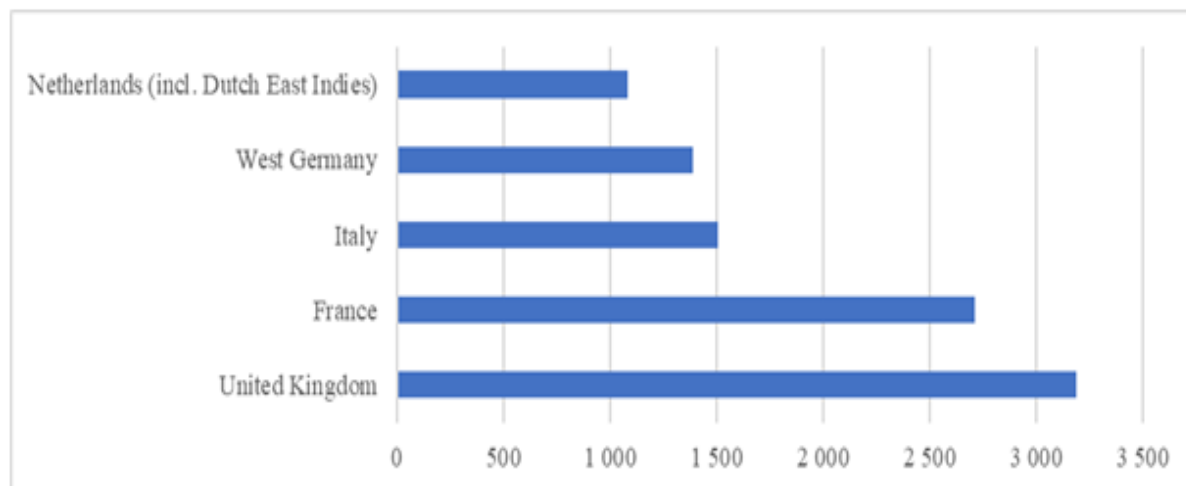


Figure 2. Distribution of aid of Marshall plan in USD millions. Retrieved from statista.com

After World War II, Britain and the United States gradually became advocates for the reconstruction of the post-war international order. But at this time, Britain's economic strength had been greatly reduced because of the war, while the United States achieved sky-high economic strength. In 1944, the United States had become the world's largest economy and the largest gold reserve country, with GDP accounting for 50% of the world's total and gold reserves reaching 63%. In 1948, the United States became the world's largest creditor nation. In order to help countries such as Europe and Japan obtain the US dollar, the United States has launched the Marshall Plan for Europe and the Dodge Plan for Japan. The United States has gradually replaced the United Kingdom as the leader of the global monetary and financial system (DeLong & Eichengreen, 1991; Földi & Medveczky, 2015; Göbölly & Földi, 2022).

The Bretton Woods system in the early stage played a positive role in promoting global economic integration and coordinating asset prices. The US dollar has gradually developed into the core of the international monetary system. However, inherent flaws are gradually exposed in the process. In addition, if the United States is to fulfill its obligation to convert gold, it must have sufficient gold reserves. Beginning in the 1950s, the US economy began to deteriorate. With the two US dollar crises and the long-term deficit, the US trade deficit expanded rapidly, and the US gold stocks quickly drained.

In 1969, at the suggestion of Professor Triffin, the International Monetary Fund introduced special drawing rights to join the international reserve system, but for many years the special drawing rights did not play the intended role. The Nixon Administration abandoned the official exchange rate in August 1971, and suspending the obligation of foreign governments or central banks to use the US dollar to exchange gold with the United States, unilaterally torturing this agreement reached by the United States government with countries around the world in 1944. An agreement. Many western developed countries and Japan implemented a floating exchange rate mechanism. In 1973, with the collapse of the fixed exchange rate mechanism, the system eventually disintegrated.

The Jamaican system is the product of the collapse of the Bretton Wood system, so it cannot be said that it is more advanced or more advanced than the Bretton Woods system. Just like the collapse of the international gold standard, the gold bullion and gold exchange standards entered into the stage are actually transitional stages. As a transitional stage system, it is always a choice and has many shortcomings. The main elements of the Jamaican system: Gold is non-monetized, international reserve assets are diversified, exchange rates are freely chosen (there are no institutional arrangements), and the use of SDR is expanded.

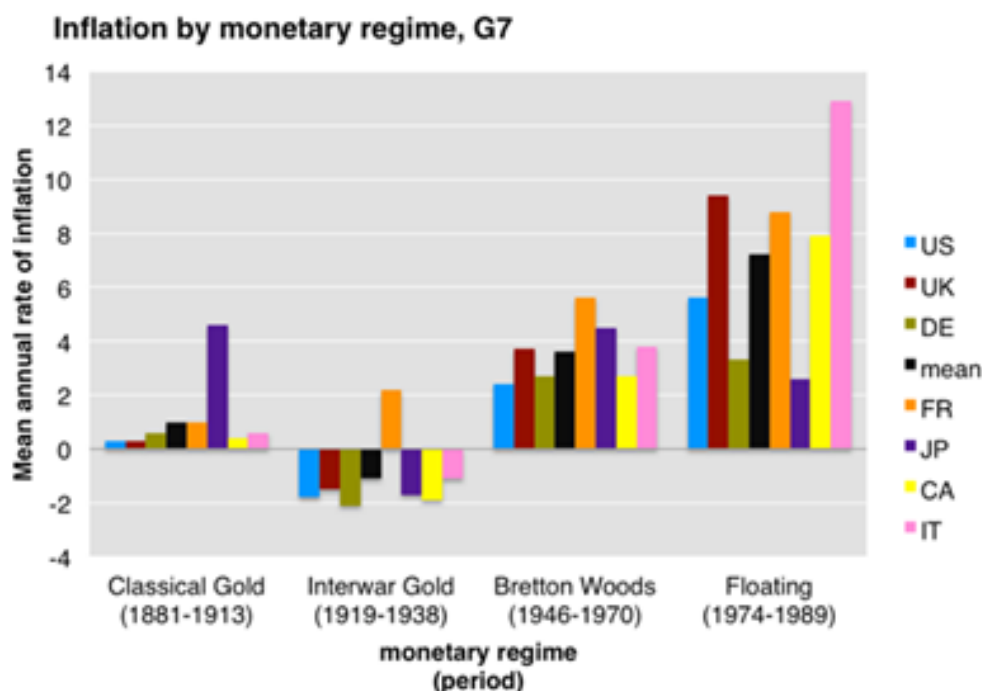


Figure 3. Inflation by monetary regime - Source: (How good was gold, 2013)

It can be seen that since the establishment of the Jamaican system, looking at the world, currency crises and financial crises have continued, and the frequent occurrence of crises has also reflected the huge flaws and instability of the system. The fundamental reason is that after the de-monetization of gold, the sovereign credit currency is regarded as the main international reserve asset, and the issuance of major reserve currencies is not subject to the restriction of gold. The over-issue of currency is widespread. The ways are increasing, causing a flood of global liquidity. At the same time, the multi-currency reserve system with the coexistence of US dollars, yen, and euros has inherent instability: changes in soft and hard currencies have caused foreign exchange reserves to flow from one currency to another, exacerbating the foreign exchange market. Risk has a huge negative impact on the flow of commodities and capital.

Second, under the Jamaican system, according to Lim, (1991) exchange rate selection has autonomy. However, the active choice of developed countries (floating exchange rate) and the passive choice of developing countries (fixed exchange rate, because developing countries lack the basic conditions for implementing a floating exchange rate system), so developed countries can better use floating exchange rate policies. In exchange for the internal and external economic balance, in the process of automatically adjusting the balance of payments, at the same time maintaining the independence of the country's monetary policy. However, developing countries must maintain external balance at the expense of internal balance. It is difficult to adjust the balance of payments imbalance and the independence of monetary policy is greatly reduced.

The Status of the US Dollar

The US dollar is still one of the most essential currencies in the global economy although it lost the character as the exclusive international currency, accompanying the rising of euro, yen and other strong currencies. Until the sub-prime crisis broke out in 2007, the US dollar's share of the international reserve system was still as high as 63.8%. The "Griffin" dilemma still exists in the Jamaican system, where the US dollar is unshackled from gold and is more freely issued by the federal reserve.

The United States flows out of the US dollar through its current account deficit and into the US dollar through its capital account overproduction. Whereas, within the BRETTON system, the operating mode is that the US dollar flows out of the US dollar through the capital account deficit and flows back into the US dollar through the current account surplus. In addition, the US dollar is not restricted by issuance. The issuance of the US dollar was also constrained by the amount of American gold. In other words, the US dollar exports are provided by the US dollar that it flows back through commodity exports. During the recent years, the exchange rate of US dollar maintained a quite high level, especially after the US election and Trump became the US President.

According to the latest statement from federal reserve chair Janet Yellen, the market expects the probability of a rate hike at the FED meeting to exceed 90%.

The question, however, is whether a strong dollar is beneficial for America, and even for the world. Indeed, much of the world is increasingly hostile to America's abuse of US dollar privileges. Because two-thirds of the US dollar in circulation is held by institutions outside the United States, all inter-bank US dollar settlement must go through the United States computer system. America recently fined European Banks billions of dollars for various reasons, citing its own financial regulations. The US fined BNP Paribas \$9 billion in 2014. Other geopolitical factors, such as sanctions against Russia, have also pushed Moscow to settle in RMB. This is accelerating the process of Eurovision. As the US dollar itself becomes a problem and is increasingly recognized around the world, this will affect the credibility of the US dollar. But for now, the US dollar's position remains unassailable.

Policy Signal of Federal Reserve and the Attitude of the United States Treasury

The Fed has complete independence in determining monetary policy, and its goal is maximum noninflationary economic growth. The Fed's interest-rate policy has a big impact on the US dollar. In addition, the Fed's intervention in foreign-exchange markets has had an impact on the US dollar. The FOMC sets policies about money and currency, including announcing interest rates eight times a year, the main one of them is the discount rate. Its change clearly indicates the change of monetary policy although this interest rate is more of a symbolic interest rate, so it could exert a greater influence on exchange rate of US dollar.

Meanwhile, the US Treasury Department has the responsibility and commitment for distributing government bonds and deciding the budget. Although it does not have right to take part in the monetary policy, it comments on the US dollar and could have impact on the exchange rate of the US dollar. Regarding to the meditation of the foreign exchange market, Fed only meditated and controlled the foreign exchange market when they agreed because both the Federal Reserve Bank and the Treasury had foreign exchange accounts.

Trump's Economic Policies

When Trump was elected the 45th President of the United States, his economic policies over the next four years attracted all kinds of attention. Trump's economic proposition is reflected in comprehensively reducing domestic taxes and imposing high tariffs on foreign countries to eliminate the trade deficit as to sincerely support American manufacturing. First, the most important part of Trump's economic proposition, which is also the most attractive tax policy to American voters, can be simply summarized as the following:

- Tax cuts for everyone. Policy by overhauling the personal income tax, Trump promised to cut taxes for the middle class and most other Americans. At a time when the middle class is shrinking, Trump's economic policies are attracting many middle-class votes. The top tax will be cut to 25 percent from 39.6 percent. The threshold for individual income tax is set at \$25,000 and \$50,000 for couples, meaning millions of families will not have to pay income tax.
- Simplify the tax code and cut corporate taxes. The corporate tax rate would be slashed from 35% to 15%, to attract companies back to America. Simplify the tax code and cut corporate taxes. The corporate tax rate would be slashed from 35% to 15%, to lure companies back to America. Large US companies are widely seeking inversions as long as US tax policy remains unchanged. But if he takes office, he will change the law so that American companies cannot use mergers and acquisitions to move their headquarters to other countries to enjoy lower tax rates.
- There will be a one-off tax on the foreign surpluses of re-shoring American firms. Trump believes his plan to slash the US corporate income tax will generate a huge amount of revenue for the US government. The tax cuts would bring back US companies that had moved overseas, and prompt them to repatriate large amounts of their foreign surpluses. It will encourage corporations and organizations to bring assets in overseas back to the United States and pay a one-time tax of 10 percent, bringing new revenue to the US Treasury.
- Close the tax loopholes in the high-end financial industry. Trump wants to eliminate the carried interest loopholes, which allow hedge fund or private equity manager to pay taxes at a lower rate than ordinary people, and he promises to reduce or eliminate most tax credits and other tax loopholes for special interest groups and individuals or companies. At this point, Hillary Clinton proposed "Buffett tax" to increase the tax burden on some securities practitioners with relatively high incomes.

Under the circumstances of tax reduction in the United States, the return of American overseas enterprises may not appear on a large scale in a short period of time. However, infrastructure construction is planned to be carried out on a large scale, and increased government spending will cause a certain scale of government fiscal deficit in the United States, which will inevitably bring a large amount of debt. In the case of fiscal deficit, the government will increase the circulation of currency, make the market value of the US dollar fluctuate, and may even impact the domestic economy of the financial countries in the world, have a bad impact on the reputation of the US dollar and the market. As for the return of overseas funds, Trump's policy advocates to some extent boost the American economy, but other relatively high costs in the United States, such as labor cost, construction cost, land cost, etc., may also hinder the return of overseas funds, and these policies have time lag, and the policy effect cannot be reflected in a short time.

Conclusion

When the Chinese Yuan depreciates against the US dollar, the price of Yuan in dollars seeks equilibrium through the interplay of supply and demand. In this scenario, the demand for Yuan shifts to the left, indicating that individuals holding US dollars are less inclined to acquire Yuan. On the other hand, the supply of Yuan shifts to the right, as individuals holding Yuan become more interested in obtaining US dollars. As Chinese consumers primarily hold Yuan, the depreciation can impact their purchasing power. If they intend to buy American goods, the cost of those goods in Yuan would increase. Assuming American suppliers maintain fixed dollar prices for their goods, the depreciation of the Yuan means that a greater amount of Yuan is needed to equal the value of a single dollar. As a result, American goods become more expensive in China, leading to a potential decrease in demand for American goods by Chinese consumers. This decline in demand can result in reduced American imports into China due to their increased cost. Conversely, in the United States, Chinese goods are typically offered at fixed Yuan prices. Therefore, as the Yuan depreciates against the dollar, fewer dollars are required to match the value of a single Yuan, making Chinese goods less expensive in the US. This competitive pricing can outbid American producers, leading to an increase in Chinese imports into the United States.

In summary, a depreciation of the Chinese Yuan against the US dollar can lead to shifts in demand and supply, impacting the cost of American goods in China and Chinese goods in the United States. This can subsequently influence the volume of imports and exports between the two countries, contributing to the dynamics of their trade relationship.

Scientific Ethics Declaration

The authors declare that the scientific ethical and legal responsibility of this article published in EPESS journal belongs to the authors.

Acknowledgements or Notes

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