MEMORANDUM

To: Members of the Committee on Financial Services

From: Financial Services Committee Majority Staff

Date: June 2, 2023

Subject: June 7, 2023, National Security, Illicit Finance, and International Financial Institutions Subcommittee Hearing Entitled "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency."

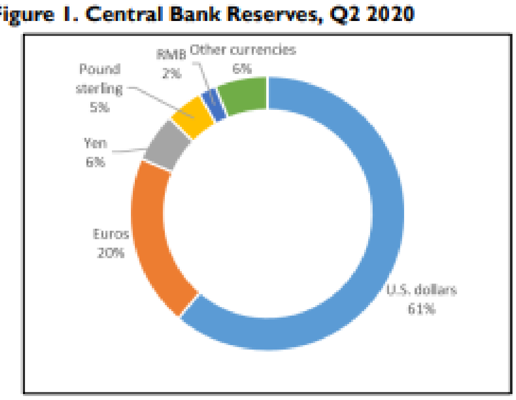
On Wednesday, June 7, 2023, at 10:00 a.m. in Room 2128 of the Rayburn House Office Building, the Financial Services National Security, and Illicit Finance Subcommittee will hold a hearing titled "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency." Testifying at the hearing will be:

- **Dr. Tyler Goodspeed:** Kleinheinz Fellow, Hoover Institution at Stanford University
- **Dr. Michael Faulkender:** Dean's Professor of Finance, Robert H. Smith School of Business at University of Maryland
- **Dr. Daniel McDowell:** Associate Professor, Maxwell School of Citizenship & Public Affairs at Syracuse University
- **The Honorable Marshall Billingslea,** Senior Fellow, Hudson Institute
- **Dr. Carla Norrlöf,** Senior Fellow, The Atlantic Council and Professor, University of Toronto

Background

After World War I, the U.S. dollar (USD) began to replace the British pound sterling as the world's dominant currency for reserves, trade, and capital flows. The dollar finally replaced the pound after the 1944 Bretton Woods agreement. By the late 1960s, European and Japanese exports became more competitive with U.S. exports. However, the large supply of dollars around the world made it difficult to back dollars with gold. In 1971, President Nixon ended the convertibility of U.S. dollars to gold, eliminating the limit on the amount of currency that could be printed. By the 1970s, the dollar composed almost 80 percent of the reserves held by central banks. However, as of the fourth quarter of 2020, that share had dropped to 59 percent.[1]

Figure 1. Central Bank Reserves, Q2 2020



Source: International Monetary Fund. **Notes:** 149 reporting countries.

[1] US Dollar Share of Global Foreign Exchange Reserves Drops to 25-Year Low (imf.org)

Nevertheless, the network effects of the USD as the global currency of choice cannot be understated. Eighty eight percent of all currency transactions by value are in USD, which has led foreign central banks to hold dollar debt to stabilize exchange rates.

The USD's place as the world's reserve currency provides the United States with a number of inherent strategic advantages. First, it limits the risk of a balance-of-payments crisis for the United States and lowers exchange rate risk. Second, a strong dollar helps American consumers by lowering the price of imported goods, which results in $25-$45 billion per year in savings. Consumers, businesses, and the federal government also see lower borrowing costs by as much as 50-60 basis points. Essentially, heavy foreign dollar reserves and expanded commercial dollar usage provides the U.S. interest-free loans in global currency exchanges. This position also provides the Federal Reserve primacy among global central banks, allowing it to operate its monetary policy with greater independence.

In addition to the benefits provided to the U.S. central bank, government, and consumers, the USD provides security for investors. During times of economic crisis, like the financial crisis of 2008-2009, the USD operated as a "safe haven" for investors. This trend remained true during the 2020 pandemic.[2]

National Security Implications of a Strong Dollar

The USD's reserve status and the strength of U.S. financial markets also provides the U.S. with a powerful national security tool: economic sanctions. Economic sanctions impede access to the U.S. financial system. This is turn provides the U.S. a targeted tool to advance foreign policy objectives and alter the actions of our adversaries. For example, to settle transactions denominated in dollars, there must be access to the U.S. financial system. Barriers to access can make cross border payments denominated in dollars nearly impossible.[3]

Because of their power, sanctions are more and more frequently applied to address national security challenges. This includes the counterterrorism efforts of the early 2000s to the current Russian invasion of Ukraine. However, some warn that overuse of financial sanctions, particularly unilateral (meaning, U.S.-only) sanctions, could threaten the central role of the USD and U.S. financial system. For example, foreign governments targeted by U.S. financial sanctions are increasingly exploring ways to reduce their reliance on the USD. This reduces a foreign government's exposure to this U.S. economic weapon.[4]

Threat From Rising National Deficit

There are also concerns that the U.S. banking turmoil, the unsustainable federal spending trajectory, and skyrocketing inflation both domestic and global are making dollar-based assets less attractive. The USD's proportion of global reserves has dropped from 72 percent in 1999 to

[2] CRS Report: The U.S. Dollar as the World's Dominant Reserve Currency
[3] Carnegie Endowment: How Sanctions on Russia will Alter Global Payment Flows
[4] Brookings: Economic sanctions; too much of a bad thing

59 percent today, as central banks increasingly diversify their investment funds and discard currency pegs.[5]

Though unlikely because of a lack of viable alternatives, over time the USD could lose its position as the anchor currency for roughly two-thirds of world GDP. This could be significant considering how much the United States relies on the dollar's special status – or what then-French Finance Minister Valéry Giscard d'Estaing famously called America's "exorbitant privilege" – to fund massive public and private borrowing. Given the aggressive deficit financing the U.S. has employed, particularly since 2020, the sustainability of its debt could be called into question.[6]

Legislation

H.R. 556, the "21st Century Dollar Act"
This bill establishes a U.S. policy to facilitate the position of the dollar as the primary global reserve currency and requires an assessment of China's currency-related policies.

H.R. 804, the "Chinese CBDC Prohibition Act"
This bill would prohibit U.S. money service businesses from engaging in transactions involving China's central bank digital currency.

[5] https://www.ft.com/content/f8f3b2cd-6690-4f26-b81e-e972751c8799
[6] https://www.theguardian.com/business/2021/apr/02/the-us-dollars-hegemony-is-looking-fragile