Testimony of Dr. Tyler Goodspeed before the U.S. House of Representatives Committee on Financial Services

To:	Members of the Committee on Financial Services – Subcommittee on National Security, Illicit Finance, and International Financial Institutions
From:	Dr. Tyler Goodspeed
Date:	June 7th, 2023
Subject:	Subcommittee Hearing entitled, "Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency"

Chairman Leutkemeyer, Ranking Member Beatty, and Members of the Committee:

Thank you for the opportunity to testify before you today on an issue of long-run importance to the U.S. economy.

I am a Kleinheinz Fellow at the Hoover Institution at Stanford University and Chief Economist at Greenmantle LLC, a global macroeconomic and geopolitical advisory firm. From 2017 to 2021, I had the privilege to serve on the President's Council of Economic Advisers as Senior Economist, Chief Economist for Macroeconomic Policy, Member, Vice Chairman, and Acting Chairman.

In 2022, 88 percent of all foreign exchange transactions, by value, involved the U.S. dollar.[1] 59 percent of all official foreign exchange reserves were held in U.S. dollars, down from 71.5 percent in 2001.[2] By comparison, 31 percent of all foreign exchange transactions, by value, involved the euro—the second-most commonly transacted currency—which accounted for 20 percent of official foreign exchange reserves.

The fact that nearly 90 percent of all foreign exchange transactions continue to involve the dollar, and that global central banks continue to hold almost 60 percent of their foreign exchange reserves in the form of dollars confers net economic benefits on the U.S. economy.

First, foreign demand for reserves of U.S. dollars raises demand for dollar-denominated securities, in particular U.S. Treasuries. This effectively lowers the cost of borrowing for U.S. households, companies, and federal, state, and local governments. It also means that, on average, the United States earns more on its investments in foreign assets than it has to pay on foreign investments in U.S. assets, which allows the United States to import more goods and services than we export.

Second, foreign demand for reserves of U.S. dollars and dollar-denominated assets raises the value of the dollar relative to what it would be if the dollar were less prominent in foreign exchange transactions and central bank reserves. A stronger dollar benefits U.S. consumers and businesses that are net importers of goods and services from abroad.

Third, large reserve holdings of U.S. currency abroad in effect constitutes an interest-free loan to the United States.

[1] Bank for International Settlements, *Triennial Central Bank Survey* (2022).
[2] International Monetary Fund, "Currency Composition of Official Foreign Exchange Reserves" (2023).

Fourth, the denomination of the majority of international transactions in U.S. dollars likely modestly lowers the exchange rate risks faced by U.S. firms.

Fifth, given the volume of foreign U.S. dollar holdings and dollar-denominated debt, monetary policy actions by foreign central banks generally have a smaller impact on financial conditions in the United States than actions by the U.S. central bank have on financial conditions in other countries.

However, the benefits of the U.S. dollar's global reserve status are not without costs. Though lower interest rates in the United States benefit U.S. borrowers, especially the federal government, they also lower returns for U.S. savers.

In addition, though a stronger dollar benefits U.S. consumers and businesses who are net importers of goods and services from abroad, it also disadvantages U.S. firms that export goods and services abroad, as well as U.S. firms that compete against imported goods and services.

Furthermore, the perception of U.S. assets as a relative safe haven means that demand for the dollar and dollar-denominated assets tends to rise substantially in response to adverse macroeconomic shocks that are global in nature. As a result, the competitiveness of U.S. exporters and U.S. firms that compete against imported goods and services are likely to face an increased competitive disadvantage at times of elevated macroeconomic stress and adverse business conditions.

Despite these costs, studies generally find that the economic benefits of the dollar's prominent global status outweigh the costs, providing a modest net economic benefit to the United States. This does not include the benefit to the United States of the dollar's centrality in global transactions allowing the United States to utilize financial sanction tools, when appropriate, in support of national security objectives.

There are economic policies that would help to preserve this net economic benefit. First, prudent fiscal policy would help to ensure that U.S. government debt continues to be the most liquid and perceived as the safest in the world. Second, economic policies that enhance potential economic growth would help to ensure that the U.S. economy remains the largest and most dynamic in the world, and thus that demand for U.S. dollars for transactions purposes remains robust. Third, avoiding excessive levels of regulation would allow for continued financial innovation to occur within the U.S. financial and payments systems rather than outside them. Fourth, restoring low and stable inflation would reinforce the dollar's status by restoring stability in the value of the U.S.

I look forward to your questions and participating in this important economic issue.