

**EconoFact Chats: The Special Role of the U.S. Dollar**  
**Linda Goldberg, Federal Reserve Bank of New York**  
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**Michael Klein**

I'm Michael Klein, Executive Editor of EconoFact, a non-partisan web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at [www.econofact.org](http://www.econofact.org).

**Michael Klein**

The dollar dominates the world monetary system. Much of global trade in goods and services is denominated in dollars. The dollar is widely used for bilateral trade between countries other than the United States. And the use of the dollar is even more dominant for financial transactions. Debt contracts are often denominated in dollars. Dollars make up more than half of the world's foreign currency reserves held by central banks. What advantages accrue to the United States from the dominance of the dollar? Are there costs associated with this as well? Does the importance of the dollar require a special role for the Federal Reserve at times of crises? To discuss these matters, I'm very pleased to welcome Linda Goldberg to EconoFact Chats. Linda is a Financial Research Advisor at the Federal Reserve Bank of New York. Previously, she served as Senior Vice President, the Head of global economic analysis, and the Head of the international research function at that bank. She's widely recognized as a leading expert on the topics of global banking, international capital flows, and the international roles of currencies. Linda, welcome to EconoFact Chats.

**Linda Goldberg**

Thank you, Michael. I'm delighted to join you. I would want to start by emphasizing that the views that are expressed are mine and do not necessarily reflect those of the Federal Reserve Bank of New York or the Federal Reserve System.

**Michael Klein**

Linda, I alluded to some of the ways the dollar is the central world currency in the introduction. Can you elaborate on this a bit?

**Linda Goldberg**

The dollar has been at the center of the international monetary system ever since the Bretton Woods Agreement in 1944. It set up a system of fixed exchange rates in which countries pledged to keep their currencies stable against the U.S. dollar.

**Michael Klein**

But the Bretton Woods system of fixed exchange rates with the dollar at its center ended in 1973. So the situation since then is different, right?

**Linda Goldberg**

Yes, this formal system ended, but the dollar still plays the central role in the international monetary system. The International Monetary Fund tracks this, and about 20% of countries

report anchoring their currencies to the U.S. dollar. Many more countries actively limit the volatility of their exchange rates against U.S. dollars. In addition, the dollar has much broader roles. As you mentioned, U.S. exports are priced in dollars, but companies abroad tend to price their exports to the U.S. in dollars as well, and use dollars even when they are not transacting with the United States. In this case, the dollar is called a vehicle currency, and in addition, many commodities, for example oil, wheat, and metals, are priced in dollars.

**Michael Klein**

So how did the dollar maintain this vehicle currency role once the Bretton Woods fixed exchange rate system ended and the formal agreements of that system were no longer in effect?

**Linda Goldberg**

Scholars of this topic start out by pointing to the relative political and economic stability of the United States, and the relative size of its economy. Other factors discussed are geo-economic and alliance-related, for example with military alliances complementary to currency use. Inertia also contributes.

**Michael Klein**

The fact that the dollar was important in 1972-1973 means that the dollar continued to be important. That's what you meant by inertia, right?

**Linda Goldberg**

That's right.

**Michael Klein**

So Linda, what's the impact on the United States exporters and importers of having the dollar serve as a vehicle currency?

**Linda Goldberg**

So when international trade transactions are invoiced in U.S. dollars, U.S. producers are less impacted by movements in exchange rates, at least in the short term. And because commodity prices are also in dollars, producer revenues and costs are not whipped around by these exchange rate movements. And dollars often are used in transactions throughout the global supply chains in which so many of the goods we consume are produced.

**Michael Klein**

I guess it's useful at this point to mention that exchange rates move a lot, much more than prices of goods and services. So that can really change the price if it was denominated in a different currency, right?

**Linda Goldberg**

That's absolutely right.

**Michael Klein**

Another important role of the dollar is in financial transactions. And again, the dollar dominates in these as well.

**Linda Goldberg**

Yeah, this is huge. For example, when companies around the world want to raise funds or borrow in international markets, around 60% of these transactions worldwide are in U.S. dollars. And when currencies trade globally, almost 90% of the turnover, again, worldwide, involves U.S. dollars. And dollar transaction costs tend to be lower. And using the dollar is associated with greater ease of financing.

**Michael Klein**

It's a situation where because everybody uses it, it becomes the standard. And once it's the standard, it's easier to use. So it's sort of this self-reinforcing process, right, Linda?

**Linda Goldberg**

That's right. And Americans do benefit from this. If Americans lend and borrow in dollars, then they are avoiding exchange rate risk. So you don't have to worry that the payment made or received will change in the value of your currency, which would be the case if Americans were using euros or pesos or yen, for example. So this offers stability that is certainly worth something to producers in the U.S. and also on the financial side to borrowers and lenders in America who use dollars in their transactions.

**Michael Klein**

Linda, some of those borrowers and lenders are banks, and not only U.S. banks, but banks around the world. A lot of your research and policy work is on global banking. And as I mentioned in the introduction, you're known as one of the world's experts in this. Can you describe what's meant by global banking and why it's important?

**Linda Goldberg**

Sure. Some large banks are also global, meaning that they set up branches and subsidiaries outside of their headquarter countries. These banks go in and they borrow and lend in these locations. And many of them also provide other financial services, for example, like wealth management to local customers. Depending on the specific business models of the global banks, they may be very active in helping to move capital to the places where it is most productive. This is also potentially beneficial to banking systems as the global structure provides diversification benefits.

**Michael Klein**

So the diversification is the old idea that you don't want all your eggs in one basket. So if you're in different countries, the risk is spread out more evenly, right?

**Linda Goldberg**

That's right. And if banks in one country are troubled or stressed, there's an opportunity for healthier banks, those that still have access to funding to come in and keep credit flowing.

**Michael Klein**

What's the dollar's special role in global banking, Linda?

**Linda Goldberg**

Yeah. So many banks that are outside of the U.S. have some of their funding sources denominated in dollars. They also have assets in dollars, assets like loans, as customers use dollars for international trade and for their financial transactions. And while we're talking about global banking, I want to emphasize it's not just banks that heavily use dollars. A large amount of dollar funding flows through different types of financial intermediaries and through a variety of market instruments. And with this kind of whole structure in place and an interconnectedness of markets worldwide, that means that both favorable conditions, and strains across financial markets and institutions can quickly transmit across the globe. It could affect financial conditions, it could affect credit provision, meaning like lending, and it even can affect monetary policy transmission in the United States and in other countries.

**Michael Klein**

By monetary policy transmission, you mean the way when the central bank changes interest rates, the effects it has on the economy, correct?

**Linda Goldberg**

That's right.

**Michael Klein**

So we talked before about why the dollar has such a dominant role. And one thing we didn't yet mention is that the dollar or more precisely Assets-backed Treasury Bills and Bonds are often viewed as what's called a safe haven. What's meant by that term, Linda, "safe haven," and what advantages arise from this?

**Linda Goldberg**

So savers and investors around the world look to hold assets that keep their value in stressful periods. And many of them look to the debt issued by the U.S. government for providing such "safe haven" features. There is a large global demand for U.S. dollar assets and U.S. dollar government debt. And this lowers the cost of borrowing for the U.S. government and for the private sector. And of course, this is especially important, consequential, when we have a big federal debt balance, and the interest burden of the debt is substantial. That burden would be even higher but for the safe haven aspect of Treasury Bills and bonds.

**Michael Klein**

The central role of the dollar is of special importance at times of stress, for example, in 2008 or more recently at the beginning of the pandemic in 2020. What policy responses have been undertaken with respect to the role of the dollar to stabilize the world monetary system at these times of stress?

**Linda Goldberg**

Yeah. So, the central roles of the dollar are really a support to world financial stability. To give you some examples from times of stress, we could think about what happened in 2008, the global financial crisis, and again in 2020 during the initial pandemic period. The markets were under strain and then the Federal Reserve undertook decisive actions that helped to stabilize international dollar funding markets. So, these are these markets where people outside the U.S.

are borrowing and lending. So, one example of this is in 2008 when the Federal Reserve established a network of dollar swap lines with some key central banks around the world. So, these swap lines provided a type of short-term liquidity in dollars to other central banks, that supported the continued provision of credit to borrowers using dollars abroad, as well as to corporate borrowers in the United States that rely on banks for loans.

**Michael Klein**

These foreign central banks then made the dollars available to banks in their own countries, right?

**Linda Goldberg**

That's right. So, the way that this works is there's a transaction between the Federal Reserve, our central bank in the U.S., and some foreign central banks, and then the central banks work with their own banking constituencies and allocate those dollars to their own banking system.

**Michael Klein**

What about in 2020, Linda?

**Linda Goldberg**

In 2020, these swap lines were reactivated. Some of the terms to make dollars available through these swap lines were adjusted. But in addition, another facility called the FIMA repo facility, FIMA in this case is an acronym for Foreign and International Monetary Authorities. The FIMA repo facility was established, and that allows foreign official institutions to temporarily exchange their U.S. Treasury Assets that are held in custodial accounts managed by the Federal Reserves for dollar cash. So, these programs make dollars available to foreign official institutions in another way from the swap lines in times of stress. And this is important because it provides broader access to a dollar liquidity backstop than the central bank dollar swap lines do. And also, it's a way that during a stress period, there's less disruption to U.S. treasury markets. So that's because foreign central banks, for example, that are holding treasuries might have tried to liquidate or sell some of their U.S. treasury assets to get cash during the stress period. And that can be very disruptive to U.S. treasury markets. They also might try to sell other U.S. dollar assets in what's called a 'fire sale' type of transaction, just getting the best price that they can, but sometimes really driving prices down of assets, possibly. And so, with this type of FIMA repo facility, they avoid selling some of these assets, but they can still get the dollar liquidity they need.

**Michael Klein**

So just to clarify, if there was a fire sale, as you say, that means the price goes down. But the price of a bond going down means its interest rate goes up, and that would be not at all good for the United States or the rest of the world when interest rates would shoot up at a time of stress like that, correct?

**Linda Goldberg**

Yeah. And some of the types of facilities that are set up for these stress periods are really intended to limit some of the amplification effects that would be caused by somebody else's stress out there.

**Michael Klein**

So these swap lines were very helpful, not only for the other countries, but for the United States as well. But did they present risks for U.S. taxpayers?

**Linda Goldberg**

These are fully collateralized transactions. In terms of the swap lines, that means that the Federal Reserve has as its counterparties some of the strongest central banks in the world. For the FIMA repo facilities, when we say collateralized, what it means is that these transactions are secured by the U.S. Treasury holdings of the foreign official institutions that are engaging in these transactions. So, dollars are flowing out just over a very short time period. Maybe these are overnight, one-week transactions. But meanwhile, we are holding on to U.S. Treasuries and that takes away that kind of risk to U.S. taxpayers.

**Michael Klein**

Linda, there's a famous story attributed to Mark Twain that he read an obituary of himself that was falsely presented in a newspaper and he wrote, 'the tales of my demise are greatly exaggerated.' There have been tales of the demise of dollar dominance for a very long period, at least going back to the end of the Bretton Woods system, and even before that. There is concern now, or at least there's talk, that the dollar could be replaced by the euro or even the Chinese renminbi. These stories are more common when we have political challenges, for example, those associated with debt, especially with the raising of the debt ceiling. Do you see a changing role for the dollar and perhaps an emergence of a parallel or maybe even a replacement currency?

**Linda Goldberg**

OK, well, first, it's the first time that I've heard Mark Twain brought up in this context. So that's great.

**Michael Klein**

Mark Twain can apply to many, many things, you know. It's useful reference for most stuff.

**Linda Goldberg**

So, I think it's worth just reminding the audience of the dollar's roles, and the status of the dollar here. So, the dollar's roles continue to be strong in international trade and international finance. After the dollar, the euro is the second most commonly used currency. And then after that, others have much smaller roles. And speaking about the euro's use, geographic proximity to the euro area and trade with euro area countries has been one of the important drivers of euro use. So, there are already multiple currencies used in the international context, but the dollar's roles continue to be strong. That said, you're absolutely right about the stories and the concerns. And we heard them when the euro was introduced, and we've heard them at many points in time over recent decades. Most recently, some officials from other countries have made strong statements indicating their intent to move away from using dollars on the international trade and financial transactions. Some of these countries also are geopolitically distant from the United States. For example, if you were to think about how countries vote with or differently from the United States at the UN General Assembly, so some of the countries making these statements are more lower alignment countries with the US. So far, this type of shift in dollar use has not been found to be very material or broad-based across countries.

**Michael Klein**

So, the dollar was dominant, the dollar is dominant, and the dollar is likely to remain dominant at least for some time.

**Linda Goldberg**

So far, that is the status.

**Michael Klein**

So the idea of dollar dominance is often mentioned in the media, but I'm not sure that people really understand what that means and what role the dollar has and what the consequences of that would be. But Linda, you helped explain that very clearly today. So thank you very much for joining me on this episode of EconoFact Chats and discussing this issue.

**Linda Goldberg**

You're very welcome.

**Michael Klein**

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