Dollarization of the World Economy

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Abstract

In the article are considerate the main aspects of the financial market influencing the country's economy. In this field, the certain historical facts are connected with the financial market. These facts show that the USA economy influence on the world's economics space determining the countries' ability to resist financial expansion and insure their economies securities. The causes of the formation of dollarization are describes as a world currency. The current situation is associated with the formation of such a global currency like the dollar. The facts are investigated as the advantages and the disadvantages of dollarization.

Keywords: dollarization, currency policy, financial market, global currency, economy influence.
JEL Nr.: * F 02 - International Economic Order; Economic Integration: General

INTRODUCTION

1. The relevance of the research topic

As a result of liberalization of international economic relations and increased financial globalization over the last three decades has intensified the process of dollarization of national economies. Dollarization is a phenomenon of the international monetary and financial relations in which the funds of other countries, often the US dollar is replaced as the national currency.

Until 70-ies of the XX century, the dollarization of the economy was characteristic only for Panama and several island and dwarf States that have no domestic currency and instead officially use foreign currency. She drew attention in the 70s as one of the key phenomena of the economic reality in Latin America, where a series of failed economic reforms led to the loss of public confidence in the national currency and the actual replacement of national currencies with the American dollar.

The failure of the authorities to curb inflation, and underdeveloped financial institutions has led to inefficiencies, and in some countries and the failure of reforms that led to the loss of confidence of economic agents in the weak domestic money and the extensive use of a strong foreign currency for transactions and savings. An analogous situation exists in Russia where for more than a decade after the collapse of the USSR, most of its functions, the ruble has sent the U.S. dollar.

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In recent years, the issues of dollarization of national economies came to the category most relevant in connection primarily with the global financial and economic crisis the end of the first decade of the XXI century, called "the Great depression". The fall in oil prices on the world market and anti-sanctions imposed in connection with events in Crimea and the Southeast of Ukraine, led to a significant devaluation of the ruble and an economic recession, so this problem has become topical in Russia, whose economy is characterized by a significant presence of foreign currency in monetary circulation. In the media increasingly, there are publications, speeches of prominent politicians, businessmen and public figures, which evaluates the prospects of the U.S. dollar, the Euro and other reserve currencies in the future, given the proposals for the establishment of alternative currencies discussed a draft of new regional currencies and currency unions. In scientific literature, there are many works devoted to various aspects of dollarization of national economies.

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The process of dollarization has very contradictory consequences both for monetary and for the economy as a whole. Unambiguous assessment of its consequences in the economic literature is still there. Around the issue of the advantages and disadvantages of dollarization for three decades conducted theoretical discussions, which are particularly actualize during the financial and economic crisis. In a crisis, as a rule, the most severe negative consequences for the economy. Financial crises tend to be more painful in countries with a significant level of dollarization, as it happened in Russia in 1998, the Experience of recent crises has shown that its level remains high for an extended period after the crisis, which significantly complicates the implementation of anti-crisis measures and the conduct of macroeconomic policy in the post-crisis period. The process of dollarization a persistent problem in most developing countries and countries with economies in transition.

Most economists consider dollarization as an extremely complex, contradictory and multifaceted phenomenon, many aspects of which remain the subject of intense debate. The question of the economic essence and content of the phenomenon of dollarization as one of the key phenomena of the international monetary and financial relations at the present stage remains open.

Thus, on the one hand, there is an objective necessity of studying of the nature and content of dollarization as one of the most significant phenomena of modern economic reality. On the other hand, the crisis of recent years, the world financial and economic crisis the end of the first decade of the XXI century, engulfed the economies of most countries of the world, as well as the crisis caused by the events in Ukraine, determine the extraordinary relevance of the study of the phenomenon of dollarization is currently. [1]

1.1 The causes of the formation of the dollar the world currency

There are a lot of countries and many have their own currency. However, the world-famous currencies are not so many, but of course, the world's first currency that comes to mind is the U.S. dollar. But as it is this currency which was born in times of war and strife between the States was transformed into the world's main means of payment?

If the beginning of the history of the dollar, is closest to modern can be considered the moment when the States bothered to depend on English currency, the beginning of the dollar as the currency impact on the world economy can be considered the years of the Second World War. That's when the American government that the war was not a financial shock, but rather a gold mine, began to give loans to countries that needed financial assistance to restore after the war. At some point, such a situation has arisen that a large part of Western Europe was directly dependent on the US, and therefore its currency. In currency trading, the dollar immediately began to enjoy enormous demand, and America became the largest industrial giant and the most prosperous country in the world, which is also the key to the success of the dollar. In connection with these factors, the dollar became the currency, which had to be considered in the first place, since its value and reliability is not in doubt. [2]

Much of what had determined the choice in favor of the dollar, was not new and was based on the old habit and practice. With rapid growth of the American economy in the late nineteenth century and the extension of its trade relations in wide use includes transactions in dollars. Businesses, individuals and governments have created around this customary institutions and practices. Dollar for decades was readily available as an exchange currency in almost every major city and port from Asia to Europe and Latin America. People have long used the dollars to contract for import and export, as well as for loans needed to facilitate these transactions. The prominent position of the currency contributed to the fact that for many years, entrepreneurs, financial institutions and Central banks held significant deposits and investments in dollars, perceiving it as a matter of course.

In addition, the rise of the dollar in the late 1940-ies illustrates the unique safeguards that are provided in the US currency. The United States and its currency became the safe haven. Along with outstanding production skills, the country had a large and strong economy. The United States also could offer a particularly rare political stability at the time. Besides, the reputation of the US as a nation of laws has ensured that the country will fulfill its obligations and secure any material benefit that is in dollars — wherever is their owner — from arbitrary taxation or alienation. The Bretton woods agreement added the attractiveness of the dollar, tying it to gold. As a gold a traditional reserve even from classical times. All this, combined with the promise of a reasonable policy, assured the people that the currency will be able to maintain its solvency.

The perfect summary provided for the dollar another important quality. The United States offered the capital markets a global scale. Thanks to them, the currency was there is a significant advantage: it provides its holders a diverse set of financial tools for placing of deposits, some of which offered safety, and some liquidity, while still others — the higher the potential profit, perhaps at the expense of safety or the degree of liquidity. Due to its huge size and continuing activities of these markets in the future convinced everyone that the investment in dollars can be quickly converted into cash, and then just as quickly converted from a dollar of cash into other currencies or gold.

Since the relative position of the United States is characterized by the ongoing recession. The dollar has progressively lost its currency value against major world currencies. The United States remains the largest economy in the world. China competes with America in terms of trade, and even the German trade is largely increased in comparison with 1970-ies. The Eurozone, of which Germany remains the largest economy and international trade volume is definitely approaching the United States. If Washington's diplomatic and military influence in from time to time is questioned, the budget deficit and financial crisis has raised a barrage of questions regarding the degree of prudence policy the United States. Someone even expressed doubts about the ability of Washington to meet its financial obligations. As if to underline all these signs of weakness, the US. In 2011, Standard & Poor's downgraded the credit rating of the country. [3]

2. The current scale of dollarization of the world economy

Currently, the dollar is most used currency in the world, which is involved in 87% of global foreign exchange transactions — a figure that grew in 2010 by two percentage points. The Euro follows behind him with a large gap, which accounts for 33%, then the yen 23%, pound 12%. The Yuan, though managed to rise from 0.9% (according to 2010 year), now he participates only in 2.2% of all global currency trading. Nearly 90% of world trade contracts totaling more than $ 5 trillion a day find their monetary value in dollars, in spite the company involved or is not involved. This surprising stability of the dollar is unlikely to bound to popular belief in the US economic or financial management. And it is not a vote of confidence in the economic power of the country or its financial health. It is also not reduced in the context of enhanced economic and trade development of China and other countries. Rather, the sustainability of this just the recognition that, despite the relative weakening of America and the relative income of other countries, no other currency at the set of their characteristics are not even able to compete with the dollar for the title of world reserve currency. [4]

Dollar decades was strengthened by the economic power of the United States. Now everything is a bit wrong. At the moment, the US share of world GDP is only 23%, of world trade was 12%. However, 60% of world production is in the area of the dollar and local currencies are pegged to the dollar.

The proportion of the US companies in the total volume of investments in the corporate sector in the world has declined from 39% in 1999 to 24%. The Wall Street in fact sets the rhythm all the world's stock markets. American managers manage 55% of the world's assets, while ten years ago only 44%.

That is the financial system which is based in the United States, and the U.S. economy – are two big differences. That is a problem for all countries, the main reasons which are:

1. High volatility. The world is afraid in anticipation of a rate hike by the FRS, as the prospect threatens to suck huge amounts of money from developing economies, where foreigners own between 20% and 50% of government bonds in local currency and they will definitely in the case of a rate increase. Rate hike threatens loans and deposits in dollars outside the United States at least $9 trillion.

Before the effect of the capital outflows was mitigated by growing demand for imports. Over the past decade, the U.S. share in world imports of goods decreased from 16% to 13%. America is the largest market for exports from 32 countries, while in 1994 these countries was 44. Meanwhile, in China, this figure grew from 2 countries to 43. Under these conditions the dollar is dependent on the decisions of the FRS in its global financial system that brings instability.

2. The threat of the lack of a backup plan for other countries. During the crisis of 2008 to help the global system came the fed with a $1 trillion to foreign banks and Central banks. But the fact that the dollar area in the world has doubled since 2007. By 2020, it will be compared with the entire banking system of the United States by volume. 1 trillion dollars – that's nothing, even in today's conditions. We have to admit that control over the global financial system the US government uses as a lever for political pressure – including on Russia. It's not really the stability of the global financial and confidence in the future.

For Americans, the status of the dollar as a reserve currency, in addition to obvious advantages, like cheap credit, and carries the obvious disadvantages. If the fed can not cope with the lending of foreign banks in the event of a crisis, it will echo on the American economy. In addition, foreign countries replenish foreign exchange reserves at such a pace that by 2030 years they will dominate the Treasury market. To satisfy foreign demand, the government will have to replenish the Treasury by increasing the debt. If, instead, foreigners will invest in other securities, this may lead to a bubble and another crisis like in 2008 year.

As the Federal Reserve System, the raises interest rates, the value of foreign dollar exchange rate usually also increases. The impact of the dollar on the world economy is most evident in its purchasing power. While increasing gas prices and depreciation of the dollar, Americans are buying less. Many exporters in the United States in this case will be forced to reduce demand for their products. Countries with less than stable economies could suffer dramatically from this downturn in costs that will reduce their exports to the United States, contributing to a downward economic trend.

The US government is trying to combat this vicious circle by promoting free trade with foreign countries and a new package of "economic incentives". This pack donates money to the American citizens in the hope that they will spend their money on food instead of accounts or investments, thereby stimulating the economy. [5]

Currently, the dollar began to attack China actively. The Officials in Beijing have openly announced about their intentions of making via official news Agency Xinhua ominous statement that "Now is perhaps the best time for to the peace, which is in deadlock start to observe the possibility of the de-Americanized world." At the February summit of the group of eight in 2014, Chinese officials accused the United States of abuse of the status of the dollar as a reserve currency and in existence due to the basic printing money, while the prosperity of the currency does in reality do not reinforce. Beijing is also not limited to only one rhetoric. He insisted that Chinese public and private companies in their international transactions used dollars instead of yuan. At last count, about seventy thousand Chinese companies have complied with this requirement. Beijing has signed agreements with several countries, including Japan, Russia, India, Brazil, South Korea, Saudi Arabia, United Arab Emirates, on the implementation of the bilateral trade in national currencies instead of dollars. As the largest trading partner of Africa, China has also successfully implemented the use of the Yuan in trade with the countries of this region.

China refused the role of main creditor of the U.S Last year. Treasury, reducing the volumes of us Treasury bonds to $1.12 trillion. Place of China occupied Japan, which total invested in the US debt of $1.13 trillion. Recall that Beijing has overtaken Tokyo in the market of US government bonds in September 2008, when the rapidly expanding global financial crisis: in November 2013, Chinese holdings reached a peak of $1.32 trillion.

Beijing explained its decision by the need to maintain the Yuan exchange rate which is dropped to an eight-year low. Only in November, the reserves of China lose $69.6 billion, helped by not only the slowdown of the Chinese economy, but the victory of Donald Trump in the presidential election in the United States, which provoked further outflows of capital from emerging markets. [6]

3. Consequences of dollarization of the world economy

No one is happy with today's international monetary system—the set of rules, norms and institutions that govern the world's currencies and the flow of capital across borders.

There are three broad complaints. The first concerns the dominance of the dollar as a reserve currency and America's management of it. The bulk of foreign-exchange transactions and reserves are in dollars, even though the United States accounts for only 24% of global GDP. A disproportionate share of world trade is conducted in dollars. To many people the supremacy of the greenback in commerce, commodity pricing and official reserves cannot be sensible. Not only does it fail to reflect the realities of the world economy; it leaves others vulnerable to America's domestic monetary policy.

The second criticism is that the system has fostered the creation of vast foreign-exchange reserves, particularly by emerging economies. Global reserves have risen from $1.3 trillion (5% of world GDP) in 1995 to $8.4 trillion (14%) today. Emerging economies hold two-thirds of the total. Most of their hoard has been accumulated in the past ten years.

These huge reserves offend economic logic, since they mean poor countries, which should have abundant investment opportunities of their own, are lending cheaply to richer ones, mainly America. Such lending helped precipitate the financial crisis by pushing down America's long-term interest rates. Today, with Americans saving rather than spending, they represent additional thrift at a time when the world needs more demand.

The third complaint is about the scale and volatility of capital flows. Financial crises have become more frequent in the past three decades. Many politicians argue that a financial system in which emerging economies can suffer floods of foreign capital (as now) or sudden droughts (as in 1997-98 and 2008) cannot be the best basis for long-term growth.

The shape of any monetary system is constrained by what is often called the “trilemma” of international economics. If capital can flow across borders, countries must choose between fixing their currencies and controlling their domestic monetary conditions. They cannot do both.

Today's system has no tie to gold or any other anchor, and contains a variety of exchange-rate regimes and capital controls. Capital controls were lifted three decades ago and financial markets are highly integrated. Broadly, emerging economies are also seeing a freer flow of capital, thanks to globalization as much as to the removal of restrictions. Countries are loth to let their currencies move freely. When capital pours in, central banks buy foreign exchange to stem their rise. Just as important are the scars left by the financial crises of the late 1990s. Foreign money fled, setting off deep recessions. Governments in many emerging economies concluded that in an era of financial globalization safety lay in piling up huge reserves. That logic was reinforced in the crisis of 2008, when countries with lots of reserves, such as China or Brazil, fared better than those with less in hand. Even with reserves worth 25% of GDP, South Korea had to turn to the Fed for an emergency liquidity line of dollars.

This experience is forcing a rethink of what makes a “safe” level of reserves. Economists used to argue that developing countries needed foreign exchange mainly for emergency imports and short-term debt payments. Consider, for example, the tension between the demand of the emerging market for reserves and Consider, for instance, the tension between emerging economies' demand for reserves and their fear that the main reserve currency, the dollar, may lose value—a dilemma first noted in 1947 by Robert Triffin, a Belgian economist. When the world relies on a single reserve currency, Triffin argued, that currency's home country must issue lots of assets (usually government bonds) to lubricate global commerce and meet the demand for reserves. But the more bonds it issues, the less likely it will be to honour its debts. In the end, the world's insatiable demand for the “risk-free” reserve asset will make that asset anything but risk-free. As an illustration of the modern thirst for dollars, the IMF reckons that at the current rate of accumulation global reserves would rise from 60% of American GDP today to 200% in 2020 and nearly 700% in 2035.

If those reserves were, as today, held largely in Treasury bonds, America would struggle to sustain the burden. Unless it offset its Treasury liabilities to the rest of the world by acquiring foreign assets, it would find itself ever deeper in debt to foreigners. Triffin's suggested solution was to create an artificial reserve asset, tied to a basket of commodities. John Maynard Keynes had made a similar proposal a few years before, calling his asset “Bancor”. Keynes's idea was squashed by the Americans, who stood to lose from it. Triffin's was also ignored for 20 years.

But in 1969, as the strains between America's budget deficit and the dollar's gold peg emerged, an artificial reserve asset was created: the Special Drawing Right (SDR), run by the IMF. An SDR's value is based on a basket of the dollar, euro, pound and yen. The IMF's members agree on periodic allocations of SDRs, which countries can convert into other currencies if need be. However, use of SDRs has never really taken off. They make up less than 5% of global reserves and there are no private securities in SDRs.

Zhou Xiaochuan, the governor of China's central bank, caused a stir in March 2009 when he argued that the SDR should become a true global reserve asset to replace the dollar.

Alternatively, China could create a rival to the dollar if it let the yuan be used in transactions abroad. China has taken some baby steps in this direction, for instance by allowing firms to issue yuan-denominated bonds in Hong Kong.

Rather than try to create a global reserve asset, reformers might achieve more by reducing the demand for reserves. This could be done by improving countries' access to funds in a crisis. Here the G20 has made a lot of progress under South Korea's leadership. The IMF's lending facilities have been overhauled, so that well-governed countries can get unlimited funds for two years.

If America's economy recovers and its medium-term fiscal outlook improves, the pace at which capital shifts to the emerging world will slow. If China makes its currency more flexible and its capital account more open in good time, the international monetary system will be better able to cope with continued financial globalisation and a wide growth gap between rich and emerging markets. But if the world's biggest economy stagnates and the second-biggest keeps its currency cheap and its capital account closed, a rigid monetary system will eventually buckle. [7]

In early 2017 the world’s most important currency is flexing its muscles. In the three weeks following Donald Trump’s victory in America’s presidential elections, the dollar had one of its sharpest rises ever against a basket of rich-country peers. It is now 40% above its lows in 2011. It has strengthened relative to emerging-market currencies, too. The yuan has fallen to its lowest level against the dollar since 2008.

However, it should be noted that America’s relative clout as a trading power has been in steady decline: the number of countries for which it is the biggest export market dropped from 44 in 1994 to 32 two decades later. But the dollar’s supremacy as a means of exchange and a store of value remains unchallenged.

There are lurking dangers in a stronger dollar for America, too. The trade deficit will widen as a strong currency squeezes exports and sucks in imports. In the Reagan era, a soaring deficit stoked protectionism. This time America starts with a big deficit and one that has already been politicized, not least by Mr. Trump, who sees it as evidence that the rules of international commerce are rigged in other countries’ favor. A bigger deficit raises the chances that he act on his threats to impose steep tariffs on imports from China and Mexico in an attempt to bring trade into balance. If Mr. Trump succumbs to his protectionist instincts, the consequences would be disastrous for all.

Nascent talk of a new pact to rival the Plaza Accord, an agreement in 1985 between America, Japan, Britain, France and West Germany to push the dollar down again, looks misplaced. Japan and Europe are battling low inflation and are none too keen on stronger currencies, let alone on the tighter monetary policies that would be needed to secure them.

Stock markets in America have rallied on the prospect of stronger growth. They are being too cavalier. The global economy is weak and the dollar's muscle will enfeeble it further. [8]

4. The conclusion

In the framework of this research lets highlight the main advantages and disadvantages of dollarization for the individual national economies and for the United States and the world economy as a whole. (see table. 1)

Table 1 – analysis of the main implications of dollarization of the world economy for individual national economies and for the United States and the entire global economy

The benefits of dollarization		
For the global economy	**For national economies**	**For the United States**
Full dollarization contributes to the creation of investment-friendly environment and almost completely eradicates speculation with the national currency and the exchange rate. As a result, the capital market is becoming more stable, it stops unexpected outflow of funds, and the balance of payments is less prone to crises	Improving the financial situation of the State. Full dollarization contributes to the creation of investment-friendly environment and almost completely eradicates speculation with the national currency and the exchange rate.	The Federal reserve system of the United States receives income from the issue of the dollars used in other countries. The national currency of the United States covers the trade deficit. Buying goods in other countries, they give in return their goods — dollars.
Full dollarization contributes to the strengthening of the global economy because it facilitates the integration of economies	Countries with a dollarized economy can enjoy higher level of trust from international investors to have a lower decline in interest rates on their external debt, reduce budgetary costs and to achieve greater investment and growth.	The demand for the American currency is posed by dollarization, supported the General demand for money in the US economy. This significantly reduces the need for open market operations to regulate money circulation.
		The strengthening of the U.S. dollar as the leading world currency. The increase in the number of countries where it serves the domestic currency, helping the U.S. currency to remain the world leader.

Disadvantages of dollarization		
For the global economy	**For national economies**	**For the United States**
Dollarization is accompanied by a change in the role of gold in the global financial system, narrowing of its functions.	A country refusing from printing their own money loses the ability to directly influence on its economy, including monetary policy and shaping exchange rates.	Uncontrolled use of the masses of the dollar abroad. Due to the fact that America has the greatest impact on the international market and interest rates, loss of control seriously reduces the effectiveness of the fed's monetary policy.
	The Central Bank loses income from the issue of money. In return, it gets the Federal reserve, and the local government lose a significant part of the funds, which is also reflected in the GDP.	The growth of political risks. If the fed for any reason will increase the interest rate, countries with dollarization economy may try to force the American government to influence the fed to have reduced it.
	National securities also must be ransomed in U.S. dollars. If the country has enough foreign exchange reserves, we have to borrow money, which leads to a balance of payments deficit.	Currency export. A large country with officially dollarized economies, or group of small dollarizing countries may refuse the use of the US dollar as domestic currency and the introduction of the national currency. A mass dumping of dollars will result, foreign exports and a sharp drop in the U.S. dollar.
	Since the national currency is a symbol of an independent state, due to the use of foreign currency may suffer a sense of citizens pride	
	In a fully dollarized economy, the Central Bank also loses its role of lender for other banks.	
	The inability to pursue an independent monetary policy. In the case of the use of foreign currency as a legitimate medium of exchange in the country's monetary policy is actually determined by the Central Bank of the country whose currency is used.	

Source: compiled by the author.

Thus, at the moment, despite the fact that the situation has changed and Europe has paid off its debts to the U.S., the dollar still remains the key currency in the world. The world trade is still largely conducted in dollars, and it is unlikely that soon this practice will stop. The issue of dollars does not stop for a minute so the whole world is daily supplied with the new currency. In the case of economic shocks, citizens of any country tend to invest all available funds in the U.S. dollars. All this determines the trust to the American currency, despite the fact that the dollar is constantly are predicting a quick death, remembering the famous national debt, people at the highest level continue to trade payments in dollars, this means that in the near future the dollar will remain the base of the world economy.

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