

Café Economics

The Dollar Game



Chess grandmaster-turned-economist **Kenneth Rogoff** talks about the moves that made the dollar king and those that could topple it

Dominance in the game of chess is about exerting control over critical squares that cover vital movement routes, not unlike the attributes of a dominant reserve currency. As a teenager, Kenneth Rogoff got his first look at the non-dollar-dominated world in 1969, when he dropped out of high school in Rochester, New York, to play world chess champions in what was then Yugoslavia. Rogoff went on to study at Yale University and was surprised to hear his professors anticipating the rise of the ruble, given the squalor he had witnessed in the Soviet-controlled Eastern Bloc.

Rogoff received a PhD in economics from the Massachusetts Institute of Technology and has published groundbreaking research on a range of topics, including central bank independence and exchange rates. He also served as IMF chief economist in 2001–03. He is currently

Rising debt and high long-term interest rates are among the greatest dangers to dollar dominance, Rogoff tells F&D.

the Maurits C. Boas Chair of International Economics at Harvard University. His latest book, *Our Dollar, Your Problem*, examines the rise of the US dollar and what might cause it to fall. He discussed its conclusions with F&D's Bruce Edwards.

F&D: How did the US dollar become so dominant as a reserve currency?

KR: The short answer is two world wars. World War I crippled Britain's economy, but sterling remained, if not the dominant currency, then codominant with the dollar. After World War II, Britain was broke, and the US, with perhaps 40 percent of global GDP, became the only game in town. There was an agreement toward the end of the war—somewhat contentious with the British—that everyone had to peg their currencies to the dollar. The US could do whatever it wanted, but with one big caveat: We had to trade dollars for gold whenever official creditors asked, which constrained our behavior. The book's title originates from 1971, when President Richard Nixon shocked the world by saying, "You know what we said about trading your dollars for gold? Not anymore. We're not going to do it."

F&D: What's different now in terms of the US using the dollar's strength to bolster its position in the global economy?

KR: Let's start with 1971, when the US went off gold. At a meeting in Rome, the Europeans and other countries on the dollar standard asked US Treasury Secretary John B. Connally, "What are we supposed to do with all these Treasury bills?" And Connally replied, "Well, it's our dollar. That's your problem." I never liked that arrogance, but after dropping the gold standard, the US didn't have a plan to control inflation. It was our problem, too.

Fast-forward to today, when we're undermining the Federal Reserve's independence and have deficit and debt

problems that threaten financial stability. Yes, it's a problem for everyone, but also for the US.

F&D: Are there pressures on central banks to become less independent?

KR: Those pressures have existed for a long time. When I first visited the IMF in 1982, I wrote the first paper on why you should have an independent central bank and how it could be a way of dealing with inflation. Others later contributed, too. I believe central bank independence has been the most impactful policy innovation of the past 70 years. People can disagree, but it's been so successful that people have forgotten why they need it.

Even before President Trump, there were populist pressures, especially from the left, in advanced economies to have the central bank help with the environment, with inequality, and so on. The pandemic was a wake-up call—maybe we shouldn't have this mission creep. But there's still a lot of pressure, particularly in the US, where the Fed is in a somewhat unique situation. But central bank independence is under assault everywhere. It's worried me before, but never more than now.

F&D: Have other currencies threatened dollar dominance in recent history?

KR: The yen was once a big deal. There was a period when Japan's economy seemed to be overtaking the US. Some of my distinguished older colleagues at Harvard wrote books about how we all should imitate Japan. Back then, Japan had half the population of the US, but its stock market and real estate were worth more. They seemed to be crushing us in everything. But we came down hard on them, and they yielded in too many areas, ending up in a disastrous financial crisis. But things could have gone differently.

China's decision to basically peg the renminbi to the dollar worked for a long time. But there was a period, starting in the early 2000s, when I was chief economist at the IMF, when we said, You shouldn't do this anymore. You're a big country and should have your own monetary policy. If you peg your exchange

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rate, it tends to make the price of non-traded goods like houses go up too fast. You're going to get inflation.

I don't think I understood all the dimensions of the problem China was facing at the time, but had they not stuck to this fixed exchange rate—which distorted their development and after a while did not work for them—the dollar's footprint would be much smaller. Today, Asia is half the dollar bloc. It might have been more like a quarter or a third if China hadn't been circling around the dollar for so long.

There are competitors to the dollar at the margin—the euro, crypto, the renminbi—all of which are chipping away at dollar dominance. But the bigger problem is that maybe investors won't see the dollar as desirable as they used to, and to absorb the burgeoning supply, they will demand a higher interest rate. The dollar could keep its number one position but lose market share.

F&D: In the book you say debt is the biggest danger to the dollar's strength and reject the popular notion that US debt is safe. Why?

KR: So there's an idea everywhere, but particularly in the US, that debt is a free lunch: that interest rates are always going to be really low, so we shouldn't worry. Well, interest rates have risen. And I believe that long-term interest rates are going to stay high for a very long time, at least on average. Structural factors are making them high, not just in the US, but in the UK, France, Japan, everywhere.

Everybody knows it's brutal if your 2 percent mortgage suddenly jumps

to 7 percent. US bond yields haven't jumped that much, but our interest payments have nearly tripled relative to GDP in a short period. They're bigger than defense expenditure. The US has to adjust to this big change and, at the moment, there's very little political will to do so. I don't blame any particular leader. We'd still have a giant deficit if we had a completely different president. It may be very hard to persuade Congress and the American people to rein things in until the economy reaches a cliff edge.

When the interest rate was zero, a lot of economists—including some very smart ones—thought advanced economies in general no longer needed to worry about debt. This bled over into the IMF's work. I gave talks all over the world warning that if interest rates don't stay low, debt service would soar. But I was told, No, they're not going up.

The dominant theme was Larry Summers' secular stagnation theory. Paul Krugman, too, seemed to argue that real interest rates would be zero forever. Olivier Blanchard, a great economist, came up with a similar argument. What if they're wrong? What if there's a war? What if we need a sudden military buildup? Maybe long-term interest rates will collapse again. But if it doesn't happen pretty darn soon—and if AI doesn't deliver politically sustainable growth, not just higher profits at the expense of labor—there could be trouble. **F&D**



This interview has been edited for length and clarity. Visit www.imf.org/podcasts to hear the full interview.