Journal of International Money and Finance 57 (2015) 1–14

Contents lists available at ScienceDirect

Journal of International Money and Finance

journal homepage: www.elsevier.com/locate/jimf

Review

# Does the US dollar confer an exorbitant privilege?

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ARTICLE INFO

*Article history:*
Available online 25 June 2015

*JEL Classification:*
E41
E43
F33
F34
F55

*Keywords:*
Exorbitant privilege
International role of dollar
Foreign exchange reserves
International investment position
International investment income
Seigniorage

ABSTRACT

This paper questions the asserted pecuniary benefits conferred by the dollar's international role. If these benefits are smaller than often claimed, then the difficult measurement of costs can be finessed. The original privilege notion characterised the dollar's systemic role in official foreign exchange reserves before 1973. Five subsequently developed notions refer to the broader, more evolutionary role of the dollar in the international monetary system. (1) As international debtor, the US borrows in its own currency – but others do too. (2) Dollar bills held offshore confer a benefit – but it is neither large nor exclusive. (3) The US Treasury may borrow more cheaply owing to official holdings – but it shares this advantage through an integrated global bond market. (4) The US earns higher yields on its external assets than it pays on its external liabilities – but this undoubted advantage arises from direct investment, far from the dollar's international role. (5) US banks may play on a home court – but they have in fact won a modest share of offshore dollar business.



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[1] The author thanks Branimir Gruic and José Maria Vidal Pastor for excellent research assistance and Robert Aliber, Claudio Borio, Richard Cooper, Guy Debelle, Philip Lane, Guonan Ma, Athol Maritz, Hyun Song Shin, Ted Truman, Kostas Tsatsaronis, Xin Wang, Frank Warnock and participants in the People's Bank of China/Reinventing Bretton Woods Committee Conference on the 70th anniversary of Bretton Woods, Hangzhou, China, 17–18 May 2014, the Center for Financial Stability conference "Bretton Woods 2014: The Founders and the Future", 3–4 September 2014, a Graduate Institute of Geneva Conference on the internationalisation of the renminbi, 17 October 2014, and at a seminar at the Bank of Korea Institute for Monetary and Economic Research, Seoul, 5 November 2014, for useful discussions. Views expressed are those of the author and not necessarily those of the BIS.

http://dx.doi.org/10.1016/j.jimonfin.2015.06.005
0261-5606/

## 1. Introduction

"If I had an agreement with my tailor that whatever money I pay him he returns to me the very same day as a loan, I would have no objection at all to ordering more suits from him". This simile of Jacques Rueff (1972, p. 78) captured the Gaullist view of the exorbitant privilege (EP). Not disciplined to settle debts in gold, the United States (US) exploited the 1960s gold-exchange standard to buy goods, services and whole companies with US dollar IOUs.

Many Chinese observers accept that the US dollar confers economic advantages on the US (Wang and Chin, 2013; Wang and Pauly, 2013). EP appeals because China makes net investment *payments despite its international creditor status* (Ma and McCauley, 2014; Wang, 2010) – while the US (the dual) receives such payments despite its debtor status. Certainly, Chinese officials hold lots of low-yielding US public bonds. Also, growing international use of the renminbi poses the question of benefits to China (Ba et al., 2010; Hai and Yao 2010; Genberg 2012).

EP's original meaning lost relevance in a world of floating fiat currencies, but EP has attracted new meanings. A second meaning holds that the US is privileged to finance its deficits in the dollar. The third through fifth meanings share the theme that the US dollar's role gives the US an easy ride in servicing its external liabilities. The sixth meaning holds that the dollar affords US financial firms a home-court advantage. In sum:

2. The US need not settle its dollar liabilities with some other asset.
3. The US can finance its current account deficits in its own currency.
4. The US runs up a zero-yielding debt to the rest of the world.
5. The US Treasury can borrow cheaply.
6. The US pays less on its external liabilities than it gets on its external assets.
7. US financial firms harvest "denomination rents" from global dollar use.

Yes, but. There is truth in each. But the privilege is small (Sections 4 and 7), not unique to the US (Sections 2–4), shared (Sections 4–6), or does not result from the dollar's international role (Section 6).

This article does not join a broader argument over whether the benefits of the dollar's international role exceed the costs (Aliber, 1964, 1966; Canzoneri et al., 2013; Cohen, 2012; Dobbs et al., 2009; Papaioannou and Portes, 2008; Salant, 1964). Cohen (2012) highlights the dollar's non-pecuniary benefits, including US prestige, akin to Hollywood's "soft power" (but see Williamson (2013).

Costs are not easy to measure. If the dollar's role has shrunk the US traded goods sector, productivity has grown more slowly (Belassa–Samuelson). Kindleberger (1973) identified leadership (for political scientists, "hegemonic") costs: counter-cyclic demand, open markets for distress goods, international lender of last resort. Then Federal Reserve Bank of New York President Timothy Geithner alluded to the last during the Federal Open Market Committee (2008, p. 21) decision to extend swaps to Brazil, Korea, Mexico and Singapore: "the privilege of being the reserve currency of the world comes with some burdens". This article does not try to measure costs but instead weighs pecuniary benefits in the above order.

## 2. No settlement

EP's first meaning is often widened: "the ability to buy *foreign goods* and companies using resources conjured out of thin air was the exorbitant privilege of which French finance Minister Valéry Giscard d'Estaing so vociferously complained" (Eichengreen, 2011, p. 40, *emphasis added*). However, the US current account surplus then meant that exports of goods and services paid for imports (Swoboda, 2012).

Americans debated whether the US gained policy flexibility (Aliber, 1964) or not (Salant, 1964) or both *seriatim* (Johnson, 1969). To Europeans, US gold not paying for US firms' European acquisitions gallingly added to a broader concern over US multinationals' organisational and technical prowess (Servan-Schrieber, 1967). Rueff stressed that European central banks were financing the competition.