Reflections on Liberal and Monetary Orders

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This forum begins with a paradox. On the one hand, we have what appears to be a steady decay of US geopolitical influence together with a concomitant erosion of the long-standing liberal international order. On the other hand we have the persistent dominance of the US dollar at the heart of the global monetary order. In the words of the forum's introduction, "recent debate about the future of the 'liberal international order' . . . suggests a decline in US influence in global affairs . . . [Yet] from the perspective of scholars who explore the elements of the global monetary order . . . the situation one of continued US dominance, with no end in sight." (Norloff and Poast, this forum). The divergence of the two trends seems puzzling. If the United States is fading as a world power, how is the dollar able to retain its decades-old supremacy in financial affairs? Conversely, if the greenback still dominates the global monetary order, why should US power and the liberal international order be in decline?

The paradox has rarely been formally addressed by scholars of either security or money. This forum rightfully draws our attention to the need for better understanding of the relationship between the liberal international order and the global monetary order and how that relationship evolved over time. The contributions are by no means in agreement on all aspects of this core issue; there is no unified vision here. But taken together the five essays do perform a highly useful service, raising questions that are vital to the future of both the liberal order and the monetary order. The value of the forum lies in the marker it lays down for further research. This will be the starting point for many future debates. The agenda for inquiry may be defined in terms of three assumptions and four questions.

Three key assumptions appear to drive the forum. First, it is assumed that dollar dominance brings additional power to the United States. This assumption is uncontroversial, though much room remains for discussion of precisely how currency power works and what are its practical limits. Second, with the exception of Wang's essay, it is assumed that the liberal international order is synonymous with US geopolitical dominance. Wang rightly questions this link, largely by pondering whether the concept "liberal international order" is well-defined.

Third, it is assumed that dollar dominance in the global monetary order will continue. This is perhaps the most controversial of the assumptions. Until recently, I would have concurred. But since the election of Donald Trump and his aggressive use of financial sanctions—not only against adversaries such as North Korea or Iran but also against friends and allies who want to do business with America's enemies—alternatives to the dollar are increasingly being sought. McDowell examines how overuse of US financial power may lead to its erosion—a "growing dollar backlash." For Norrlof, this presents a "financial statecraft paradox," encouraging alternative pricing standards and payments systems. Khanna and Winecoff hedge their bets, conceding that American monetary hegemony could be compromised by "deeply misguided" policies or "egregious leadership." Today the greenback's perch at the peak of the global currency hierarchy is looking increasingly precarious.

Is it possible that the end of dollar hegemony is nearer than assumed? The issue is hotly debated among monetary specialists. It is true, of course, that there appears to be no single rival currency today ready and able to rise to the top anytime soon. The euro is plagued by grave issues of sovereign debt and divided leadership. Japan's yen is burdened by prolonged economic stagnation and a shrinking population. Wang is undoubtedly correct that it could be decades before the renminbi can make a serious bid for parity with, let alone supremacy over, the dollar. But, this does not mean that America's money is unchallenged. At the margins, diversification is accelerating into a variety of substitutes for the greenback. Europe would like to implement an independent payments system to bypass US sanctions on Iran. China is actively promoting use of the renminbi to pay for its oil imports. And many central banks are now buying gold to bolster the security of their reserves. The risk to the dollar is not a quick collapse but rather a more slow-moving process akin to bleeding from a thousand cuts. The threat is not a wolf at the door but more like termites in the woodwork.

Given these three key assumptions, there does indeed appear to be a puzzle. For the last three-quarters of a century, both the liberal international order and the global monetary order have undeniably been dominated by the United States. Both orders have served US interests. Both have supported US power. The relationship between the liberal order and the monetary order has been essentially symbiotic—a sort of virtuous circle of mutual endogeneity. Dollar supremacy has reinforced US influence in the liberal order; US dominance of the liberal order has reinforced the centrality of the greenback in the global monetary order. In the words of the forum's introduction, "dollar hegemony is a *product of* and an *enabler for* continued American international primacy" (emphasis added). Thus it does indeed seem paradoxical to now observe a growing divergence between the two orders—a gradually weakening liberal order alongside persistent dollar strength. A closer look at the relationship between the liberal international order and the global monetary order does seem warranted. Inquiry naturally decomposes into four distinct questions.

First, was dollar supremacy a precondition for the rise of the US-dominated liberal order? For several of the contributors, there is no doubt on this point. According to the forum's introduction, "monetary prominence has been a precondition for the viability of great-power order-building projects more generally." Khanna and Winecoff summarize pithily: "money shapes the order." The logic is familiar. The issuer of a dominant international currency is largely freed from a balance-of-payments constraint. Effectively, external deficits can be paid for by simply printing more of the nation's money. Hence diplomatic and security-related initiatives, up to and including costly foreign wars, can be pursued abroad that might otherwise be unaffordable. France's Valéry Giscard d'Estaing knew what he was talking about decades ago when he called this America's "exorbitant privilege."

Familiarity, however, does not necessarily make the logic incontrovertible. It is obvious, of course, that for an aspiring order-builder, the exorbitant privilege helps. But is it *necessary*? A glance at history suggests otherwise. The nineteenth-century Concert of Europe dominated by the United Kingdom emerged decades before the pound sterling took center stage in global finance. Likewise, America's later rise to great-power status began well before the birth of the dollar standard in the years between the two world wars. In neither instance can it be claimed that it was money specifically what shaped the political order. Far more influential, arguably, were such key factors as manufacturing capacity or sea power. The claim that monetary prominence is a precondition for a world order's rise rests on shaky foundations.

Second, was the liberal international order a precondition for the emergence of dollar supremacy? Perhaps it was the other way around. Much more persuasive is an argument that it is not money that initially shapes the global order but rather the global order that helps shape the use of money. At issue is the capacity of the dominant power to promote its own currency. In previous publications, I myself have made the case for the importance of national security considerations—especially foreign policy ties and military reach—in molding currency preferences (see, for example, Cohen 2015, 102–134). In this forum, the geopolitics of currencies is discussed by Norrlof and by Croteau and Poast. As Norrlof puts it, "[b]oth historical and contemporary evidence suggests international currency choice may indeed be security-driven." Both focus on today's dollar standard.

Norrlof concentrates on three key political mechanisms that would seem to play a role in determining a currency's broad international appeal. These are military power, security provision and defense commitments, and political affinity. Her analysis suggests that all three factors are important, though she underscores that robust empirical evidence is mostly lacking. Croteau and Poast, by contrast, focus on one illustrative case—America's relationship with Saudi Arabia. In this relationship, they stress, "maintaining the dollar's status . . . became a concerted policy pursuit." Since as far back as the 1970s, following the first global oil shock, Washington has extended broad security guarantees to the Saudis in exchange for continued Saudi support for the dollar.

Security considerations may very well matter when governments decide on the currency composition of their reserves. But as Norrlof acknowledges, private demand, not just reserve currency demand, matters. Spotlighting the reserve role alone "misses a key element"—namely, use of international currencies at the market level for either commercial payments or portfolio investment—as McDowell reminds us. For market actors, geopolitics is apt to be of rather less salience. For exporters and importers, the "gravitational pull" of a money's issuer—the size of its economy and its rank in world trade—will matter more. Likewise, for international investors, the sophistication and openness of each issuer's financial markets are most likely to prove pivotal. At the market level, it is not the political order but rather more mundane economic considerations that tend to determine currency preferences.

Third, could the US-dominated liberal international order endure without dollar supremacy? Is it the case that, without the exorbitant privilege, US power would be significantly compromised? On the one hand, Norrlof summarizes: "If the United States loses its grip on the international monetary order . . . its status as primus inter pares in the international system could unravel." On the other hand, Wang's piece holds that "[a]lthough the dollar system coincided with the post–World War II economic order . . . the decentralization of currency power from the United States is not necessarily a challenge to the liberal international order." It may simply mean displacement of the dollar at the peak of the order by one or several rivals, with no significant change in the essence of the order itself.

Finally, could the dollar remain dominant without the liberal international order? I have already suggested that there is reason to suspect that the end of today's dollar hegemony may not be so far in the future as widely thought. It may well be that what appears to be a paradox is actually little more than a behavioral lag due to the well-known influence of inertia in international currency choice. We know that high switching costs can act to slow down processes of monetary adaptation. Khanna and Winecoff add the impact of what they call "endogenous network processes"—the idea that the monetary system is governed by positive feedback mechanisms that are endogenous to network structure, which has helped to keep the dollar in a core global position despite the erosion of America's advantages. On this account, dollar supremacy may follow the LIO into decline—just not right away.

That was certainly the pattern in the case of the pound sterling, which remained a top international money long after Britain's geopolitical position began its painful descent from global empire. The same, in time, could happen to the greenback, as some of the forum's contributors explicitly acknowledge. Khanna and Winecoff hedge their bets, conceding that network endogeneity could eventually be overcome if the erosion of America's advantages becomes severe enough. Norrlof calls attention to the dire risks for the dollar posed by contemporary trends in the liberal international order for different reasons. "[I]f there is uncertainty over alliance ties, or security guarantees, or if political sympathies and proclivities start to shift, currency holders may start to diversify their reserve portfolios . . . [S]ecurity-induced reserve currency support may grind to a halt . . . [T]he total effect of cascading reserve portfolio adjustments could be devastating, dethroning the dollar from its perch as king currency." That is certainly a danger worth exploring.

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