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# Book Review

## *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*

Barry Eichengreen
New York: Oxford University Press, 2011, 240 pp.

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Over the last century America's money—the dollar—has come to dominate the global monetary system. It is used not just by Americans, but is used in other countries, in the global black market, by importers and exporters, and is the primary reserve currency for central banks. This status is what the author rightly calls the "exorbitant privilege" because it confers numerous benefits to individuals, companies, and government. Collectively, it also includes the ability to consume beyond our ability to produce.

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Professor Eichengreen chronicles the rise of the dollar to world dominance, what that means to the US and then explores the possibilities of its demise and possible crash. The author should be commended for at times thinking outside the mainstream box, where such issues are often ignored.

He believes that the world is heading to a state where there are several reserve currencies, notably the euro and the Chinese renminbi. He bases that belief on the idea that reserve currency status is based on economic strength and that Europe has economic strength and that China and India are growing in economic strength.

This is the type of change to expect and even applaud because it would mean the end of the monopoly on reserve currency and force the Federal Reserve to behave better. He does not foresee a complete breakdown of the dollar because that is not even in the interests of countries like China. He (p. 8) finds that the only thing that could create a flight from the dollar is "serious economic and financial mismanagement by the United States."

The book begins with a quick history of money, banking and trade. Although the author has a theory that economic dominance leads to monetary dominance, the US became the world economic power by the end of the 19th century, but the dollar had virtually no international role well into the 20th century.

In fact, the US only was able to make its "debut" after having established a central bank to help organize the money markets and after WWI had made a US role a necessity. I was glad to see the author's openness and honesty when describing the people who established the Federal Reserve and their motives. Eichengreen (pp. 24-25) openly described it as a conspiracy by "big finance" against the general public.

After WWII the US dollar was by far and away the dominant currency. It used this influence to establish the fundamentally flawed Bretton Woods system. This system established the dollar as the world's reserve currency convertible into gold at $35/ounce. The system was abused by the over issue of dollars which started to generate pressure for convertibility as early as the late 1950s.

Ludwig von Mises was a leading opponent of the Bretton Woods system and the leading proponent of returning to a real gold standard. This is an important point because one of Mises's followers was Jacques Rueff, the popular economic advisor to French leader Charles de Gaulle. Eichengreen (pp. 52–53) correctly describes the French as the leading opposition to the Bretton Woods:

> Rueff acquired de Gaulle's ear. He also acquired the public's (due to his successful inflation-fighting policies). When de Gaulle attacked the dollar at a press conference in early 1965, castigating the Bretton Woods System as "abusive and dangerous" and arguing that the world should return to a gold-based system, he was channeling Rueff.

Of course the French would continue to pressure the dollar and eventually force it from its perch. The rest of the chapter on the dollar's dominance provides a concise history of the 1960s and 1970s. Here the author provides real value by drawing the reader's attention to important considerations of the period that now apply to similar issues that China faces today, like what to do with all their depreciating dollars.

The next chapter discusses the improbable euro. While the book makes Americans look like arrogant brutes, this chapter makes Europeans look like immature wimps, and Germans are depicted as dupes. Overall, it provides a convincing indictment against the idea that government should run the monetary system.

Given the post-WWII history of government management of money and banking, it was astonishing to me that Eichengreen blamed the current economic crisis on inadequate regulation and too much competition. There are over 100 regulatory agencies that supposedly oversee the financial industry and over 12,000 financial regulators in Washington DC alone. At the state, federal, market, and international levels virtually everything in financial markets is regulated by multiple agencies except a few things where turf battles between agencies remain and activities are unregulated.

Eichengreen is correct to criticize the Federal Reserve for adding too much fuel, i.e. money and credit, to the economy. It should be obvious that this was the primary problem—the necessary condition.

However, there are two more big problems with the Fed. First, by continuing to bail out financial markets, over decades, they have created an enormous moral hazard problem that encourages participants to incur too much risk in their investments and operations. Second, by acting as a cheerleader for things like credit default swaps and collateralized debt obligations, the Fed creates a moral suasion problem of directly encouraging the use of these things amongst inexperienced participants.

When it comes to conclusions we find that the dollar still dominates the world. The euro is an existing rival and the Chinese renminbi is a future rival. This rivalry should make the dollar a more responsible currency. If this book goes into a second edition, then this chapter will require some editing.

He (p. 147) does mention gold, but only to dismiss it. "Finally, there are some minor alternatives to be dismissed. Gold has its bugs." (p. 147) It is dismissed largely on grounds that gold is "inconvenient" and because central banks have not shown interest in it. There is really nothing inconvenient here. Gold, silver, and copper coins minted in various weights could easily serve as money, could be transferred electronically, and could be done so either in its own denominations (i.e. 5 gram, 10 gram, 25 gram, etc.) or in other denominations (e.g. dollars, euros, etc.).

Eichengreen seems to downplay the possibility of a crash of the dollar and the loss of its currency reserve status. He finds that the dollar could crash for three reasons: China dumping the dollar, loss of confidence by investors, or continuous runaway government spending. He finds reasons why each of these causes is a low probability event.

In contrast, I view the three causes as united and to be a higher probability event. Continuous runaway government spending seems to be firmly baked into the cake of future events. Ballooning deficits and a exploding national debt being monetized by the Federal Reserve are shaking investor confidence in the long run value of the dollar and this includes other central banks, such as the Bank of China.[1]

There is a good deal of good information in this book and some interesting discussions of such things as the roles oil markets and the military plays in reserve currency status. The main problems with the book come in areas of interpretation, where the author fails to question the status quo.

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[1] The reviewer believes that events occurring between the time this review was written and submitted and the time it went to press have increased the probability of monetary crisis, and that the crisis will come sooner rather than later.