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America's Most Ignored Export

In an age in where many question the strength of U.S. industry and the ability of its government, it may seem surprising that there is one product for which the United States is the world's undisputed leading exporter, and that the good in question is produced by the public sector. The product is currency: greenbacks. It is estimated that each year some $20 billion of cash, two thirds of net output, flows overseas.

This flow is a boon for the United States economy and particularly the American taxpayer. In effect, Uncle Sam gets to buy a dollar's worth of goods and services in exchange for issuing a dollar bill. Each dollar bill is very much like an interest free loan from the holder to the United States government. If individuals did not willingly take this money, the government would either have to raise taxes or increase its formal borrowing in the bond market to cover the difference. The savings from not having to do so are enormous. Currently there is about $390 billion of dollar denominated currency in existence. If the government had to issue securities to cover this amount, the annual interest cost would exceed $25 billion. That would be the equivalent of adding 5 percent to each American's income tax bill.

The staff at the Federal Reserve estimates that about one third of the available currency circulates in the United States, the rest overseas. There is no way of knowing for sure where the currency circulates since only the transport of large amounts of currency needs to be reported. Staff estimates are based on careful statistical comparisons of the seasonal variation in currency demand. Here at home, there is a large seasonal demand for dollar denominated cash at certain times of the year like Christmas when spending is high. That is not true overseas, where most dollars are held either as a store of wealth or to carry on types of transactions which do not vary much over the course of the year.

The fact that perhaps as much as $250 billion of U.S. currency exists overseas -- $50 for every man, woman, and child on the planet -- is particularly surprising when one realizes that such holdings are purely voluntary. Here in America, dollars are legal tender. By law, you must take them to settle any debts. With a very few exceptions, the dollar is <u>not</u> legal tender outside of the United States. Its acceptance therefore cannot be attributed to the force of law.

Why then do people hold dollars? Often people do not have faith in their country's own currency. This may be the result of a history of inflation or monetary mismanagement, a lack of monetary infrastructure, or of a lack of confidence in the political situation. For example, countries in the former Soviet Union appear to be among the biggest current importers of U.S. dollars. It is estimated that as much as $100 million of greenbacks flow into Moscow every day. Part of the reason for such currency demand is the absence of an efficient check clearing operation. This means that all transactions must be made in cash.

Argentina offers another example. There, U.S. currency was the most important type of money in circulation. It was estimated that dollar holdings amounted to $26 billion, equivalent to 11 cents for each dollar of Argentine GNP. By contrast, domestic holdings of U.S. dollars amount to only about 2 cents for each dollar of American GNP. In Argentina, when large transactions take place, such as the purchase of real estate or automobiles, the buyer often arrives at the "casa de cambio" or exchange house with shopping bags full of U.S. dollars and places them on the conference table where a professional inspects the dollars. If the transaction takes place in a less formal setting, the notes may be photocopied or the seller's family may record the serial numbers.

In the Middle East, the use of dollars is widespread. During the 1990 Gulf War, for example, a large segment of wealthy Kuwaitis converted most of their wealth into greenbacks in advance of Saddam's armies. When trouble threatened again in 1994, U.S. shipments of currency to Kuwait surged. Elsewhere in the Middle East, a U.S. bank official witnessed a novel kind of dollar transaction. Two wealthy Saudis were dickering over the price of a prize Arabian horse. The seller wanted "three", the buyer offered "two". In the end, the buyer prevailed and had his chauffeur produce two "bricks" of U.S. currency. Each brick was a 10 pound stack of U.S. $100 bills, worth $400,000, and still in the original Bureau of Engraving and Printing shrink wrap.

Clearly currency has its uses. It is lightweight, giving it a clear advantage over gold. For example, that prize Arabian could also have been exchanged for about 140 pounds of gold bullion. Currency offers privacy, even anonymity, giving it a clear advantage over checks. Furthermore, it is easy to use and readily accepted.

But these advantages accrue to many currencies, not just the U.S. dollar. At present two other currencies seem to be enjoying a rising rate of usage in the world -- the German mark and the Japanese Yen. On the other hand, the British pound, though still used throughout the world, has seen its international role diminish sharply during this century. The fate of the pound should offer us a lesson.

The dollar currently enjoys some clear advantages. First and foremost, it is universally recognized. This is largely the result of the widespread nature of U.S. culture throughout the world. In this, the dollar is not unlike the Coca Cola trademark. People around the world can look at the product and get a sense for whether it's the real thing.

Second, the dollar is more accessible to the common man because of the relatively low minimum denomination notes available. The smallest German note is the 10 DM, worth about $7. This is a fairly hefty threshold throughout much of the third world. On the other hand, the U.S. does seem to be handicapped on the upscale market. Our $100 bill is the largest allowed by law, while the German 1,000 DM note is worth about $635.

The dollar's third advantage is the long history we have of allowing virtually untrammeled mobility of capital. While well intended, reporting requirements on the international movement of dollars do diminish the credibility of our currency. And, with each passing year of peace and world wide prosperity, the reputation and credibility of other countries currencies grows. This is particularly true in Japan where the development and sophistication of capital markets is rising at a rapid pace.

Having a currency which is widely accepted and used throughout the world is of untold advantage to our country. At a minimum, we enjoy the budgetary saving that widespread currency holding entails. At the other extreme, it is hard to imagine New York retaining its role as the world financial capital, or having the widespread overseas presence of our financial institutions if the dollar did not also have its international role. And in a more modest way, small U.S. companies seeking to do business abroad surely have an advantage in being able to price their products in a familiar currency.

Preserving the international role of the dollar should therefore be a national priority. To some extent there is little we can do about the increasing credibility and importance of the Yen and the Deutsche mark. But, we can and must avoid unilaterally weakening the dollar. Although the greenback has many advantages, consumers of currency ultimately look for one attribute: the ability of the currency to hold its purchasing power. The Bundesbank, which issues the Deutsche Mark, has a legal responsibility to maintain the mark's value. In recent years, the Bank of Japan has adopted a very credible anti-inflation strategy for the Yen. If the U.S. does not continue to pursue a credible anti-inflation strategy for the dollar, then our currency's role around the world is sure to diminish. The dollar may be America's most ignored export, but we ignore its importance to our economy at our own peril.