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Is the US Dollar at Risk of Losing International Dominance in the 21st Century?

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Ekonomi Amerika Serikat di awal abad 2005 ditandai dengan menurunnya nilai US Dollar terhadap beberapa mata uang asing terutama Euro. Disamping meningkatnya surplus perdagangan China, salah satu penyebabnya adalah defisit perdagangan internasional dan defisit anggaran pemerintah. Defisit ini banyak dibiayai oleh investasi keuangan asing. Pertanyaannya: apakah US Dollar akan kehilangan dominasi internasional? Meskipun ada kecenderungan ini, seakan pemerintah Amerika Serikat tidak begitu memberi perhatian dan tidak berusaha meningkatkan nilai US Dollar.

Ekonomi AS juga harus menanggung beban meningkatnya biaya kesehatan masyarakat sehingga ingin restrukturisasi sistim *Social Security.* Masalah lainnya adalah isu pengangguran karena penciptaan lapangan kerja tidak secepat yang diharapkan. Program penurunan pajak juga memberi beban terhadap ekonomi. Selain pemecahan masalah ekonomi tersebut, jika ingin meningkatkan nilai US Dollar Amerika Serikat perlu meningkatkan tabungan nasionalnya sehingga defisit dan hutang tidak hanya dibiayai oleh investasi asing.

Introduction

The American economy at the point of the 2nd term of President Bush was characterized yet with the weakness US Dollar. Fear of recession, on 31 January 2001 after Bush took office, the Fed again cut interest rate 0.5%. Another half percentage point interest rate cut was on 20 March 2001. There was prediction that the economy was still in the dip and the Fed might cut interest rate again in a few months and the interest rate in US became very low. Only in the year 2004 the Fed started to increase the interest rates to avoid higher inflation. However, since trade and government deficits were still significant, US Dollar exchange rate kept decreasing. Is US Dollar losing its international dominance? The answer to this question is the main theme in this discussion.

An analysis of American Economics at the early of 21st century should include at least the issue of unemployment, privatization of social security system, the cost of war, the Dollar crisis, international trade deficits, budget deficit of President Bush administration, Federal Reserve monetary policy, the weakness of US dollar and a question whether the US Dollar is losing its international dominance.

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The discussion is a step to see the trend and direction of the American economy. The economy is still influential to the global economy in the future. Basically in the early 21^{st} century, American economy is still the largest in the world, with an approximately $10 trillion economy in total. With the population of 284 million, it has approximately 40% share of the world economy. Therefore it is always interesting to keep track of American economy for general understanding of its impacts to where the direction of the global economy as well as of our country's local economy.

Unemployment, Increasing Cost of Health Care, and The Cost of War.

The issues of unemployment and the job lay-off were very important in the discussion of the US economics in the early 21st century. The first quarter of the year 2001 showed a lot of lay-off among important technology business such as the CNN, Cisco, Motorola, Microsoft, and many others due to business loss. People worried such lay-off will mean an increase in unemployment rate. Although government announced that what is exposed is the lay-off only, not the new job available. So far the unemployment is still under control, 4.2% with 135,000 new jobs in February 2001. However, whether there will be an increase of unemployment rate in the US will depend on the growth of the economy.

The biggest increase in new jobs was in the year 2004 when 2.2 million jobs were created. This is the biggest number since the year 2000. The highest jobs creation was on December 2004 when 157,000 jobs were created. The economic growth of the year 2005 was expected to be lower than the year 2004 and the jobs creation will be slower. Although job creation was steady in the year 2004, this achievement is still far from previous expectation since it left still the unemployment rate of 5.4%. This means unchanged compared to the previous years. The biggest job creation was in the service sector, especially in business and health care service. The weakest rebound was for the employment of factory workers.

An important issue in American economy is the restructuring of social security system. The future imbalance between benefits and the premium of the social security system could in the long run burden the US government budget. The increase in health care cost, the incoming of significant number of retirees out of the baby boomers is expected to burden the social security program. The US Administration claimed that it is a crisis and a drastic change is needed in the social security system. They said that the current system will lead the system unsustainable. The cost kept increasing up to 15.3 % of the GDP. The premium collected by the insurers is predicted to become much larger than the benefit received by the social security system. The cost of Medicaid and Medicare are increasing. The government proposed privatization of the social security system.

Another issue that gave pressure to the US economy in the early 21^{st} century is the cost of war. Iraq war was an economic burden to the US. The budget increased much higher than expected. The increase in budget was to maintain security due to insurgency. The cost was estimated to reach 130 Billion US Dollar. The cost of war was said to increase US government budget deficit. Besides, the military spending also increased up to 18% of the total government budget. The war budget was widely suspected to be low estimate since the US government did not announce how much more would be spent.

The Economic Deficit of President Bush Administration

In the early 21st century, the US experience deficit both in international trade and it government budget. In International trade, American export is only two thirds of its imports. The US has also experienced current account deficits for quite a while. The US also became a net creditor country. Financial return in the US is also lower compared to several major economy in the world. The highest trade deficit was in the year of 2004 when it reached 60 Billion US Dollar in November 2004.

There was a big jump in trade deficits. American export went down for most of the products, The export of agricultural product as well as the product of capital goods went down. This downturn in export caused significant job loss in labor intensive industry as well as in the production of high skill and high technology products. In the year 2004 The trade imbalances was extremely high with China (16.6 Billion US Dollar) as compared with other countries such as Japan (7.29 Billion US Dollar) and Canada (7,30 Billion US Dollar)

The fixed exchange rate between Chinese Yuan and US Dollar was blamed as the culprit for the serious trade deficits. China was expected to change into a flexible exchange rate. China was also claimed to practice unfair trade since they gave subsidy to exporters and they violate the patent law. The trade imbalances increased china foreign exchange reserves and it also increased China's investment in the US by buying US government bonds.

President Bush administration also changed to position of economic surplus claimed by President Clinton in the early 2001 into a deficit economy in the year 2004. President Clinton claimed that US budget was surplus by US$ 3.2 Trillion. Now it is recorded that the deficit had accumulated. Besides the slow economy, the deficit is to finance war and to accommodate the lower government receipt due to lowering tax. The deficit is also shown by the sum of debt up to 2.4 Trillion US Dollar in 2004.

Before Bush took office, in 2000 American economy was in fear of economic recession. There was a slow growth of job creation in the beginning. However in the year 2004, there was a steady growth of job creation, yet it did not change the rate of unemployment and it creates deficits and government debt as shown in Table 1.

Table 1

Historical Perspective of American Debt

PRESIDENT	TERM STARTED	TERM ENDED	DEBT AT START	DEBT AT END	TOTAL INCREASE (US$ Mill)	PERCENT CHANGE PER YEAR
JOHNSON (D)	22 Nov 63	20 Jan 69	308,933	360,018	51,085	3.2%
NIXON (R)	20 Jan 69	9 Aug 74	360,018	493,622	133,604	6.7%
FORD (R)	9 Aug 74	20 Jan 77	493,622	664,852	171,230	14.1%
CARTER (D)	20 Jan 77	20 Jan 81	664,852	940,528	275,676	10.4%
REAGAN (R)	20 Jan 81	20 Jan 89	940,528	2,720,742	1,780,214	23.6%
BUSH (R)	20 Jan 89	20 Jan 93	2,720,742	4,188,092	1,467,350	13.5%
CLINTON (D)	20 Jan 93	20 Jan 01	4,188,092	5,725,695	1,537,603	4.6%
BUSH (R)	20 Jan 01	20 Jan 09	5,725,695	(2.4 TRIL Deficit IN 2004)		

Source: http://home.earthlink.net/~arison/debt.html

Tax Cut Economics

Tax cut was the main theme of two previous Bush campaign. The tax cut value is $1.6 trillion for 10 years. The spread of tax between 8.8% to 26.2% will become 8.3% to 24.1%. The decrease is 0.5% for the taxable lowest income group and 2.1% for the highest income group, see Table 2. The tax cut is aimed to help American economy and American families. The number of families who will be free from tax is 6 millions. It is expected families will have more money to boost the economy. Bush thinks that Federal government cannot manage some program such as adult education since it is tailor made for every family. This tax cut among other is to help families to have more money for their expenditure. The tax cut is planned to be retroactive per January 1st 2001.

The implementation of tax cut is in line with planned debt cut of $2 trillion in ten years. This will leave $1.2 trillion government debt in ten years. This plan is different from the Democrat Al Gore and John Kerry who planned to decrease government debt into zero in ten years. The debt held by public is $3.4 trillion in 2001 and it is expected to decrease into $3.22 trillion in 2002. It went down and the debt was $2.4 trillion 2004

National income growth is expected to be 4%. It reached 5% in 2004, but it will go diwn again 4% in 2005. Thiswais a little more than inflation. It is very low compared to 6% in the last three years. Starting from his campaign theme, President Bush is optimist that central to American economics is the implementation of his Tax Cut program. It is worth of $1.6 trillion over the ten years period. President Bush found strong opposition to this program and the vote is predicted fifty-fifty in the Senate. Economic recession challenges the tax cut implementation in the beginning. The tax cut program will slower the payment of American debt. It is targeted to be zero in ten years by the Democrats

THE BUSH TAX CUT BY INCOME LEVELS

Citizens for Tax Justice, a tax research group, calculated how the Bush tax proposal would affect taxes at different income levels. The top 20 percent of households is divided into three groups because the range of incomes of more than $64,900 is so large.

FEDERAL TAXES AS A PERCENTAGE OF INCOME

INCOME GROUP	INCLUDING INCOME OF	CURRENT CODE (1999)	BUSH TAX CUT*	PERCENTAGE POINT DIFFERENCE **
Bottom 20%	Less than $13,600	8.8%	8.3%	-0.5
Second 20%	$13,600 to $24,400	15.2	14.2	-1.0
Middle 20%	$24,400 to $39,300	19.9	18.5	-1.5
Fourth 20%	$39,300 to $64,900	23.8	22.0	-1.7
Next 15%	$64,900 to $130,000	26.9	25.3	-1.7
Next 4%	'$130,000 to 319,000	29.1	27.9	-1.2
Top 1%	More than $319,000	37.1	32.0	-5.0
ALL HOUSEHOLDS		26.2	24.1	-2.1

* When fully phased in, in 2010 ** Based on unrounded numbers

Include are personal income taxes; Social Security and Medicare pay roll taxes; corporate income tax apportioned by ownership of capital; estate and gift taxes; and federal excise taxes on items like gasoline and cigarettes.

Source: The New York Times 02/11/2001

Center to the Argument of pro and cons was the theme of who gets the benefit out of Bush's tax cut program. It is a question of the vertical equity of the tax cut. Who is better off among the different income groups. The most extreme case is to compare who gets more benefit between the 1% highest income group or the 1% lowest income group.

Besides, there was a question whether tax cut means deferring tax since future tax will be higher to pay back national deficits and debt.

Underlying the idea of the tax cut is that under the plan there will be an elimination of tax for at least 6 millions families with children of the low income group. Besides, the share of the tax from the 1% highest income group will increase from 31.5% to 32.6%. In average, the income group of 30,000 - 50,000 will receive 19% tax cut while the income group above 200,000 will receive only 7%. Besides, if tax is too high for the higher income group, there will be no incentive to work harder and it ended up that the country's growth is low.

Democrats, however see it not from percentage point of view but from the amount of fortune Dollar the richer families will receive out of the tax cut. Taking from the calculation of the accounting firm Deloitte &Touche (New York Times, March 4, 2001), Democrats see that a tax cut of $410 (41%) will be received by a childless couple with $20,000 income, a tax cut of $1,930 (56%) will be received by a middle class family with two children with $55,000 income, a tax cut of $13,453 (13%) will be received by a couple with two children with $400,000 income, and drastically a tax cut of $47,114 (15%) will be received by middle age couple with grown children with $ 1 million income.

From the different amount Dollar they receive from the tax cut program, it shows that the richest is better off. The rich family can even spend the money for a luxury car out of the tax saving, while the low income family can only spend the money for some clothing or an annual bus fare. In total, Democrats also see that the 1% highest income group with average $ 1 million income will receive between 22% and 45% of tax benefit while the 60% poorest income group with below $44,000 income will only receive less than 13% of the tax benefit. So it is the windfall for the wealthy.

The causality also runs the other ways. Since the US is in recession in the first few years of the 21st century. It decreases the demand for Asia products. This decreases the Asian purchasing power for American technology products. The US sees Asia as a fast growing market for technology, but it is different at this time of the year since the global economy is also slower.

Bush would like to inject the money to the people, family, and the entrepreneur in the US, through tax cut. He thinks he has a sense of crisis and it needs the support of the Senate to implement the tax cut plan. Retroactive to January 1st, 2001 tax cut is a must to stimulate the economy. If the tax cut and the interest rate cut are successful to stimulate the economy, some analysts even predicted that the stock might go up to 12,000 in a year.

During presidential campaign, Greenspan opposed the tax cut economic plan. Later his response was softened and it was not the tax cut which would become the problem to the economy but the increase of the government budget deficit or the lower government surplus that matters. He proposed that tax cut program should be linked with the program of reducing debt. Tax cut program should be implemented gradually taking into consideration its effect to the national debt.

Monetary Policy to Avoid Inflationary Pressures

When the Fed cut interest rate 0.5% in early January 2001, it was expected that the economy recovered which could have showed the V-shaped (it recovered immediately) of the economy. The Fed then cut 0.5% again but the economy still seemed sluggish. Another interest rate cut was a half percentage point on the 20 March 2001. Interest rate cut is still expected and people hope that the U-shaped (it regained not that long) economy will come. However, a longest recession can happen. In that case people feel worried that the economy will be of the L-shaped (a long recession). If it is an L shaped, how long it lasts should be taken into serious consideration since the global world also faces economic recession.

The change in the monetary policy was in the year 2004 when the Fed shows the fear of inflationary pressure. To avoid the pressure the Fed raised the interest rates earlier than their initial plan. At first, the Fed cut interest rate a half percentage point early January 2001, people thought that it would safe the economy and stocks would have roared. The investors felt confident that the recovery would soon come. However, even after the Fed decreased the second 0.5% interest rate cut on 31 January 2001, the Dow Jones remained flat and the NASDAQ went down by 5% of its value. Another interest rate cut was 0.5% on 20 March 2001.

In the early January 2001 people thought that the recession would soon be over and they gave positive response and at that time people had strong confidence of Mr. Allan Greenspan. The fact that Mr. Greenspan had to decrease against the interest rate meant that the Fed failed to take the country out of recession and the investors did not act immediately after the monetary measure on 31 January 2001. On the 20th of March 2001, the stock felt immediately after a half percentage point interest rate cut.

One view said that the corporate earning is influential especially that of the industrial technology. In the year 2001, Asia is still influenced by its economic crisis. It did not end in 1999 as people thought of. Stock market volatility, commodity prices, unemployment and other signs remained in the economy. The growth of technology helped a lot but whether it will remain in the future is the future look of the economy.

Economists wondered the fact that in the year 2001 the increase of input production such as energy could not be passed into the increase of the price of goods. Some data showed that there was even some decrease of prices for other than energy related goods. This is a problem to corporate earnings. This is the pressure to the potential profit. This is a tough situation which can mean the problem of enduring recession. This is also one of the reason why people think that the Fed might still decrease the interest rate in several months to come. The change of the economy with steady job creation came in the year 2004 closed to the election time. The Fed feared of inflation due to moving economy started to decrease the interest rates.

The Weakening of The International Dominance of US Dollar

Due to deficits and weak economy, since early 2002 US$ has kept falling its value against several major currencies, however the drop was even more serious in the early December 2004. Several countries like Russia, China and Indonesia stated that they were going to reduce their US $ reserve and to lessen the purchase of American Government bonds. Actually, if the US government concerns with the exchange rates of US Dollar they should increase their saving so that their deficits would be financed by domestic investment.

The US $ has been dominant internationally since after the WW II. At that time the US current account was surplus and the value of the US Dollar pegged to gold. Its dominance is to the advantage of the US economy since it helped pay its imports and the US could borrow US Dollar with lower domestic interest rate. The dominance of US Dollar showed that as if there is not yet any alternative for US Dollar as a dominant international currencies and foreign exchange reserves.

The US Dollar had at least 80% the world foreign exchange reserves in the 1970's. Its dominance kept decreasing and it had only 65% of the international reserves today. Is the US Dollar losing its international dominance yet? A similar situation occurred in the 1990's. Yet the US Dollar is still dominant so far. However, the present situation is a bit different. The Euro currency is widely used and strong. The countries where Euro is used have low interest rates. This can make Euro an alternative dominant currency for international reserves.

Looking at the current weakness of the US Dollar, actually the US current account deficit had been there for two decades. It seems that the US government do not pay enough attention to the international dominance of its currencies. Although the current account had been deficits for quite a while, it did not change the global dominance of the US Dollar. Therefore there was no reason for the US government to worry. The US might become over confident in term of the dominance of the US Dollar in International foreign exchange reserves at present time. The US lets Dollar fall its value against several major currencies. There is not enough effort to strengthen the currency.

Besides the presence of Euro as an alternative, the weak US Dollar was also due to US economic deficits. Foreign countries felt the impacts of the US recession. When Japanese Prime Minister Mori had a talk with President Bush, he reported the problem of Japanese economy caused by the US economic recession. However, Americans think "Japan got into trouble by protecting its business from overseas competition." (William Safire, 2000:2) Besides, Japan also faces serious deflation. India made some preparation to face the US recession, which means India's export to the US supports its economy. China even compared to Japan has actually bigger trade surplus with the US. US recession is predicted to threat this export earning.

The year 2001 became a boom period for China whose second class electronic goods could be exported to the US. The US needed imported second class goods and parts due to the decrease in purchasing power. On the other hand Chinese goods became better and marketable in the US. Trade deficits with China, Canada, and Japan increased. The US Dollar is weakening. As an alternative currency, Euro became stronger and inflated against the US Dollar. The Euro fulfilled the criteria to become dominant globally.

Conclusion

American economy is in the pattern of business cycle with boom and bust period. However, at the last two quarters of the 2004, the economy was better. The dip still characterized the early part of the 2001, but the year 2004 near the election time the economy started to grow. However, the tax cut plan, the cost of war, unemployment became a burden to re-bounce the economy. Furthermore Trade and budget deficits weakened the value of US Dollar

Foreign countries such as China responded to the US recession by selling their cheaper products. It increased the US trade deficits. Domestic government budget deficits and trade deficits gave pressure the US Dollar exchange rates. Global foreign exchange reserves in US Dollar decreased especially since Euro could become an alternative reserve. The US should increase its saving so that its deficits will not be paid by foreign financial investment. Otherwise, The US Dollar might lose its international dominance.

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