Other people's dollars, and their place in global economics

By Paul Krugman
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Soon after arriving here, I stopped at an A.T.M.; I needed some dollars, and all I had were dollars.

O.K., weak joke. What I needed were Australian dollars — Aussies — not U.S. greenbacks. There are actually four English-speaking countries with dollars of their own; the others are the Canadian loonie and the New Zealand kiwi. And you can learn a lot about the global economy, busting some popular monetary myths, by comparing those currencies and how they serve their economies.

All four dollar nations are, if you take the long view, highly successful economies. True, America is still recovering from its worst slump since the Great Depression, Canada is being hit hard by plunging oil prices and Australia is feeling nervous as its markets in China wobble. But we're all wealthy nations that have weathered economic storms better than most of the rest of the world.

While the dollar nations have all done well, however, they occupy very different positions in the world economy. In part, I mean that quite literally: Australia and New Zealand are a long way from everyplace, while Canada, most of whose people live near its southern border, is effectively closer to the United States than it is to itself. And the U.S. is, of course, an economic giant around whose gravity smaller economies revolve.

These differences in geographic position go along with big differences in the nature and role of international trade. Australia is basically an exporter of raw materials and agricultural products; Canada sells a lot of these goods, but it's also a major exporter of manufactured goods to its giant neighbor.

So what can we learn from these dollar success stories? What myths can we bust?

First, we learn that even relatively small countries closely linked to big neighbors can maintain monetary independence.

In Europe, you often hear the claim that opting out of the euro, choosing either to retain or to restore one's national currency, would be disastrous. A dozen years ago, when Swedish voters rejected the euro, they did so despite overwhelming insistence by the elite that doing so would be a terrible mistake. But the elite were wrong, and that should have been made obvious by the example of Canada, which has done fine, and retained a lot of monetary autonomy, despite its close ties to the superpower next door.

Second, we learn that what right-wingers call currency "debasement" — a decline in a currency's value in terms of other currencies — can be a very good thing. Canada was able to combine spending cuts with strong growth in the 1990s because exports were raised by the depreciation of the loonie. Australia rode through the Asian financial crisis of 1997-98 with little damage thanks largely to a falling Aussie. In both cases times would have been much tougher if the countries had been using U.S. dollars, or worse yet been on the gold standard.

Third, we learn that people pay far too much attention to the role national currencies play in the international monetary system.

It's true that the U.S. dollar is special: It's a reserve currency that other countries accumulate; it's the currency in which many international contracts are priced. And you often hear assertions that the widespread use of U.S. dollars outside our national jurisdiction has big implications, for better or worse.

Sometimes these assertions involve the claim that the dollar's special role is an important source of American power; recently both John Kerry and President Obama warned that failure to ratify the Iran nuclear deal (which I strongly support) would threaten the dollar's pre-eminence. Sometimes, by contrast, the dollar's special role is presented as a burden: I've seen a number of analysts argue that global demand for dollars helps keep the U.S. trade deficit high.

But a glance at Australia shows that both positive and negative claims about the international role of the dollar are wildly exaggerated. The Aussie dollar plays no special role in the world monetary system, yet Australia has consistently attracted bigger inflows of capital relative to the size of its economy — and run proportionately bigger trade deficits — than the United States.

What's important for both capital and trade, it turns out, is whether your economy offers good investment opportunities under an umbrella of legal and political stability. Whether you control an international currency is a trivial concern by comparison.

So we can learn a lot by following the dollars — all the dollars, not just those bearing portraits of dead presidents. And what we learn in particular is that monetary economics should be approached pragmatically, not in terms of mystical notions of value.

Take it from those who share our language, but not our currency: There are many ways to make money work.