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The Role of the Real Economy in Resisting Dollar Hegemony

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Abstract: At present, the losses caused by COVID-19 have affected the economic construction of many countries, but the underlying essence is that the dollar hegemony uses weaponized currency to force other countries to participate in the process of financialization. The dollar's extracorporeal circulation has been affected by the external force of the new coronavirus, making the dollar's control weaker, and many single-industry countries have also derived the idea of getting rid of the dollar's control, which have been solved in countries with strong real economies. By exploring the role of the real economy in combating US dollar hegemony, this paper points out that a country with a strong real economy can make its internal supply chain more complete, create jobs and control inflation at the same time, reduce the possible damage caused by financial risks in the process of dollar hegemony, and play a positive role in the recovery of the economy after damage.

Keywords: Real economy, Dollar hegemony, Financialization

1. Introduction

The Great Depression of 1929 is widely regarded as the worst economic downturn in modern history. It began with the Wall Street stock market crash and lasted for several years, with profound and immeasurable negative effects on industrial production and people's livelihood. The 2008 financial crisis, which began with the collapse of the subprime mortgage market, also dealt a devastating blow to the global economy. It can be said that the US dollar - or Wall Street - holds the economic lifeblood of the world, de Gaulle's evaluation: "large-scale monetary weaponization action"[1]. In 2023, with the bankruptcy of the Bank and the Bank of Silicon Valley, a series of chain reactions by the dollar hegemony system of declining forces are spreading. Scholars point out that the persistence of dollar hegemony is due to the overwhelming monetary power of the United States and its ability to mobilize capacity through different forms of power[2]. By becoming a medium of exchange, a unit of account, and a store of value, the US dollar transmits the power of the underlying economic organization with the US dollar, and puts pressure on the real economy from other aspects such as talent absorption and geo-economic erosion, thus spreading the hegemony of the US dollar to other developing countries and forcing them to financialize. However, countries with a strong real economy, including manufacturing, agriculture, construction, etc. can be highly resistant to this erosion process. The real economy can ensure the integrity of the internal supply chain, as well as improve employment, control inflation and reduce social pressure, which can make the country strong monetary flexibility and resilience, and can help the country recover from the financial crisis. China during the 2008 financial crisis and the Covid-19 era is on example. Lissovolik believes that the crisis in the global supply chain is mainly due to sanctions and trade restrictions, as well as protectionism promoted by some developed countries. In particular, unilateral sanctions by some countries are forcing developing countries to restructure their value chains[3]. Therefore, some countries have carried out the reconstruction of the monetary system to de-dollarize. As a country with a strong real economy, it has assumed the vanguard role in this process.

This paper first studies the background of economic pressure of dollar hegemony, the process of dollar hegemony devours real output, and the contradiction between the financial industry and the real economy; Then the paper examines the stability of the real economy and how this stability plays a role in countering the hegemony of the dollar. Finally, this paper studies China as a strong real economy country as a practical case to discuss the role of the real economy.

2. Economic Pressure under the Background of US Dollar Hegemony

In 2023, the world is facing downward economic pressure. The ostensible causal factor for this global economic recession is the COVID-19 epidemic. However, the underlying reason is the interest rates increasing policy of the Federal Reserve, which is to maintain the hegemony of the US dollar and results in countries whose currencies are highly linked to the US dollar bearing inflationary pressure. The hegemony of the US dollar, through the influence of other aspects, forces other countries to use the US dollar as the first unit of account, as a medium of exchange, and as a store of value and becomes the most frequently traded and most widely traded currency carrier in the foreign exchange market. The stability of the US dollar enables the United States to constantly exchange dollars for national real economic industries, and then use its monetary influence to spread the threat of US dollar hegemony to the main economic lifeline industries of various countries, realizing the use of currency to manipulate national industrial types and forcing developing countries to become the production slaves of a single type of industry. After that, the United States used the unlimited interest rate hike to create the illusion of global market prosperity, forming a huge asset bubble and aggravating global economic risks.

3. Transfer Financial Risks through the Hegemony of the US Dollar

According to Goldstein (2021), in the process of the Covid-19 epidemic, the US dollar has continued to consolidate the hegemony of the US dollar through a series of lending, interest rate hikes, and other operations [4]. Meanwhile, Zhang (2022) points out that the US dollar index is also rising, and the hegemony of the US dollar has not been significantly affected[5]. However, this two articles published did not anticipate that a series of chain reactions caused by interest rate hikes would appear in 2022. In 2022, global inflation was estimated as high as 6%, and even in Western Europe, North America, and Southeast Asia, it will be higher than 5%. Developing countries with finance as the core of development, such as Lebanon and Turkey, are the most affected by inflation[6]. In addition, the inflation in the United States itself has hit a 40-year high. By the end of 2023, global inflation is forecast to be as high as 7%, and although global inflation is expected to slow in 2026, it will remain high in countries such as East Africa, North Africa, and South Asia. However, emerging market countries have frequent emergency stops, flights, and surging capital flow anomalies[7].

Since March 2022, the dollar has raised interest rates six times in a row. This has left a large number of countries highly dependent on financial value creation with huge losses: inflation, devaluation of their currencies, and capital flight. If a country fails to adjust its currency strategy in time for this crisis, it will become the next Southeast Asia, wiping out the value of the entire Treasury at the snap of Soros's fingers, becoming a victim of the dollar's stable currency. Under the huge inflationary pressure, the British pound has raised interest rates four times in a row, which further compressed the investment potential of the British mainland, affected employment and production, and thus made the labor value of the people endorsed by the dollar. Other developing countries are also rapidly withdrawing their capital and flowing to the United States, which exposes them to huge risks of debt crisis and exchange rate crisis. The predatory nature of the dollar allows the Federal Reserve to squander other countries' capital at will, while the exploited countries are likely to restructure their industrial structures again and again to meet their export needs, and the dollar's hegemony sadly persists.

In the context of fiscal and monetary lending, the Fed has grafted its risks onto other regions and countries. Even so, Silver Gate Bank and Silicon Valley Bank went bankrupt one after another, and such traces declare that the U.S. financial market is on the verge of collapse[8]. Scholars pointed out that the bankruptcy of Silicon Valley Bank was only abnormal in the financial, material, and real estate industries, and the impact was limited to the financial sector[9]. But bank failures mean dealing with shocks, the last of which devastated the global economy in 2008, and the failure of these two banks is a wake-up call or a start. Instability in the financial sector spreads to the general stock market, to the financial sectors of each country, and real sectors of the economy such as oil, gas, and industry[10].

4. Contradictions between the Financial Industry and the Real Economy

The relationship between the real economy and the financial industry is complex. It is not simply A affecting B or B affecting A. For example, although the development of the real economy usually leads to changes in the financial sector, and rich countries need more credit to fund their activities, it does not mean there is a positive correlation between banking services and real output. According to Cetorelli, there is even a reverse causality between banks and the real economy, which is particularly evident during financial crises[11]. Since financial crises are usually the result of excessive accumulation of various economies and capital, it is difficult to attribute the losses suffered in economic and financial aspects to a certain independent variable in the event. However, evidence from around the world suggests that deliberate government intervention in the expansion of the financial crisis has reduced bank financing, with significant negative effects on the real economy. On the surface, at least, most countries in the face of an economic crisis usually use policy intervention to prevent a currency collapse, and this process often entails the sacrifice of the real economy.

In addition, the financial industry has absorbed a large number of talents in the development process, some of which come from R&D-intensive industries. This has resulted in relatively slow growth in skill intensity in such industries, suggesting that the boom in finance has come at the expense of productivity and growth in the real economy[12]. After these talents were absorbed, the complex financial instruments developed could successfully bypass financial regulation, which was transmitted to the real economy and harmed the stability of the real economy. The bubbles generated in the production process are much higher than the real value of the real economy, further increasing financial risks. In addition, in terms of geographical factors, large enterprises will continue to put pressure on small enterprises, and eventually acquire small and medium-sized enterprises, so that they can participate in the process of capital accumulation in the financial industry[13]. The geographical expansion of financialization will also bring serious consequences to regions where SMEs are dominant. Financialization will increase competition in product markets and deplete profitable investment opportunities in the real sector[14], while the economic slowdown will continue for 40 years and will get worse[15].

Financialization is a slow and fragile accumulation, which impacts the macroeconomy by affecting the exchange rate and stock price, as well as the economic vulnerability by affecting the debt level of enterprises[16]. In addition, the International Labour Organization found that global financialization led to a decline in wages[17], while the expansion of financialization also involved households as units. The combination of household credit and a "boom" in the housing sector has made loan consumption the main driver of GDP. There are signs that the real economy and the prosperity of the financial sector have a certain degree of conflict.

5. Defense Force of the Real Economy

For most highly financialized countries, the sustained damage of financialization to the real economy is almost irreparable and will limit real wage growth and damage the labor market, which will continue to worsen the economy[18]. However, a strong real economy allows an economy to respond effectively when faced with a financial crisis. The highly liquid, predatory nature of the dollar allows it to eat away at the value of a country's productive real output, but once a country's supply chain is sufficiently circular, it can reverse course against crisis events at the expense of the financial sector. During the COVID-19 pandemic, a country lacking manufacturing needs to be higher involved in the foreign supply chain cycle than any other time, which makes the country vulnerable to the dollar. Countries with more circular supply chains allow companies to work with their domestic counterparts to keep the supply chain of critical goods and services intact. Such a well-developed supply chain must be supported by a strong real economy.

In addition, in the face of major crises such as COVID-19 epidemic, the real economy created many jobs, guaranteed social order, reduced unemployment, created sources of personal income, alleviated social pressure, and avoided material shortages and social unrest. At the same time, decoupling from the financial sector means that inflation indicators are easier to control, making life less stressful for households. It can be said that the development scale of the real economy is positively correlated with the country's ability to resist risks and recover. The last global financial crisis cost the economy $30 trillion, but it was confined to the financial sector. With the loss of millions of people for $50 trillion, the negative impact of this missing workforce is impossible to estimate.

In the early stage of the epidemic, the RMB exchange rate depreciated to a certain extent, and most foreign trade windows were closed due to the epidemic, which increased the cost of international trade. In this case, most enterprises adjusted their strategic goals to China's domestic market, and the internal circulation of the supply chain made China a closed economy, with only masks, ventilators, and other equipment still exported to foreign countries. China has maintained a surplus even as the rest of the world's net exports have fallen sharply. These surpluses enabled China's foreign exchange reserves to continue to increase in the early to middle period of the epidemic and became a major force against the dollar in the post epidemic era[19].

According to the data for April 2023, China's CPI rose 0.1% year on year, and since September 2020, China's CPI has been stable below 2%[20]. Compared with the United States, Eastern Europe, South America, and other countries facing a greater crisis, countries and regions with very good inflation like China, Russia and Western Europe, all have strong manufacturing industries. In 2021, the GDP of the real economy of the United States (including the primary and secondary industries) was $4.433 trillion[21], while that of China was $8.277 trillion[22]. Therefore, today, with the failure of the Bretton Woods system, China can continue to run its de-dollarization strategy, and Russia is also constantly converting oil resources into other currencies such as rubles. The real economy has shown some defensive strength in resisting the encroachment of financial side effects.

6. China as a Case of Using the Real Economy to Counter the Hegemony of the US Dollar

The unprecedented double decline in the long-term and short-term attractiveness of the dollar after about 2000 was largely the result of China's emergence as a new export-oriented industrial power[23]. The biggest difference between this and the prosperity of Japan, the four East Asian Tigers, and other economies in the past is that the prosperity of these countries was consciously planned by the United States to radiate its geopolitical influence. However, China's strong real economy, with its strong productivity and exports, has allowed China to grow beyond the control of the dollar, and its large amount of US Treasury debt and well-established internal circulation system have made China not afraid of financial sanctions. The Trump administration has weakened the node of interdependence between the two, which has also stimulated the construction of circulation in China's supply chain to a certain extent, and also stimulated China's growing trade surplus.

Unlike China, the UK is a country highly dependent on the financial sector. According to data, from 2011 to 2021, the number of the tertiary industry in the United Kingdom accounted for 80%[24]. In the face of social crises such as the new coronavirus, the financial crisis, the real economy of the United Kingdom is more likely to fall into a greater crisis. During the COVID-19 epidemic, the industries in the UK that have been hit hardest are mainly tourism, banking, insurance, and other tertiary industries[25]. Former research points out that the economic losses added up to 30 percent of GDP, and 80 percent of small and medium-sized enterprises were significantly affected[26]. In the event of a financial crisis, the economies of highly financialized countries will become more vulnerable. At the same time, China's GDP has maintained good stability. The economic difference between China and the UK is that China is an exporter while the UK is an importer. According to the IMF, the UK's GDP in 2022 will be £2,491.2 billion and the trade deficit will reach nearly £10 million. At the same time, according to data from Commonslibrary, the UK's trade deficit will expand from 2021 to 2022, which will make the UK more dependent on basic goods produced by other countries, and more vulnerable to the influence of financial instruments such as exchange rates, which will cause economic instability[27]. They are also more vulnerable to control by other countries and their economies are more vulnerable. At the same time, China's trade surplus in 2022 was 5.863 billion yuan, and China has maintained a trade surplus during the COVID-19 period, because China's production capacity is larger than its domestic consumption capacity, so China has been able to hold more foreign exchange reserves to fight financial crises. Under the premise of a high internal economic cycle, such a high trade surplus can still be associated with China's strong real economy. In a good financial situation, China's economic trend is different from that of other developing countries involved in the vortex of financialization, but it seize the opportunity to rapidly develop a real economy and break away from the control of China's economy by the US dollar hegemony using financial means such as manipulating the exchange rate.

7. Conclusion

Financialization will gradually erode the real economy, forcing enterprises to participate in the process of financialization and securitization, so that the output value will be equivalent to USD. The disconnection between the value presented in the data and the actual output will cause the output value to be seriously undervalued and thus easily acquired. As a result, pillar enterprises in highly financialized countries will be controlled by the Federal Reserve, thus building the hegemony of the USD. However, due to the contradictions between the real economy and the financialization process, the rapid development of the formed real economy can restrain the financialization infection caused by the dollar hegemony to a certain extent. The real economy can not only stabilize the integrity of the country's internal supply chain but also ensure that part of employment, consumption, and social pressure is in the safe line so that the country can have a certain ability to digest the financial crisis. China's case also proves that a strong real economy makes the country a strong ability to fight risks, and even can turn some risks into opportunities to develop its other industries. The development of the real economy can erode the process of the real economy is all-sided, and it is also infected from small enterprises to large enterprises. While focusing on economic development, the more stable the real economy and the higher the degree of control of the country, the higher the risk resistance ability.

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