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THESIS SUMMARY

Ákos Dani

**Crisis and search for alternatives: the international monetary system
at the beginning of the 21st century**

Ph.D. thesis

Supervisor:

István Benczes, Dr. habil
professor

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Table of contents

1. Research background and justification of the topic	4
2. Methods used	8
3. Results of the thesis	13
3.1. Concentration of the international monetary system	13
3.2. The euro as a rival to the dollar	14
3.3. The renminbi as a rising international currency	16
4. Summary of conclusions	18
5. Main references	20
6. The author's related publications	24

1. Research background and justification of the topic

In the period following the outbreak of the 2008 world economic crisis more and more studies were published about the challenges the international monetary system would have to face and the declining significance of the dollar in the world economy. Not only the emerging countries expressed their doubts regarding the international monetary system, but voices highlighting the weaknesses of the system grew stronger in the United States as well, also predicting the decrease of the dollar's role.

Looking back from 2015, the decision of the U.S. president Nixon in 1971 to cancel the direct convertibility of the dollar to gold meant not only the end of the Bretton Woods system, but also of all international monetary systems. Following the classical gold standard system successfully used before World War I, then the gold standard restored after World War I, bringing mixed results, and the Bretton Woods system established in 1944 the decades following 1971 can be described with the notion "non-system". (Mateos y Lago et al [2009]) This means that the monetary system of the last decades was not scarred either by a comprehensive international agreement, or a dominant exchange-rate system, or the ground rules widely accepted by central banks. If one element should be named that held together the system of the last decades, it would be the U.S. currency. The leading role of the dollar, the dominance of which - according to some analyses - began in the 1920s and was undeniable after World War II, remained unbroken even after the fall of the Bretton Woods system. (Eichengreen [2011]) With its advantage and regional focus varying from time to time, the dollar is still the most important international currency, that is, key currency of the world economy. The potential competitors in the '70s, '80s and '90s, such as the Deutsche Mark and the Japanese yen, did not manage to even approximate the international role of the dollar.

Since the turn of the century, however, there has been a lot of talk about the probable decrease of the influence of the dollar in the near future. (Chinn – Frankel [2008], Portes – Rey [1998]) With the introduction of the euro, the single European currency, for the first time in economic history a viable alternative to the dollar has emerged. Although the United States became a net debtor in the 1980s, the real acceleration of the process took place at the beginning of the 21st century. The indebtedness of both the state and the private sector, the state budget and the current account deficit amplified the voices questioning the long-term viability of the international leading role of the dollar. The global economic crisis originating from the United

States and accelerated by the bankruptcy of the Lehman Brothers in 2008 directed the attention to the weakness of the dollar, and in a broader sense, to the deficiencies of the international monetary system even more. The erosion of trust in the international monetary system is shown by the rapid accumulation of foreign exchange reserves by emerging countries, which has been characteristic of the world economy since the 1990s and was broken only temporarily by the 2008 crisis. As the side effect of the experience taken from the Asian crisis and the economic policy relying upon the undervalued exchange rates, amounts of reserves higher than ever were accumulated by emerging countries, primarily by the Asian countries. (Wijnholds – Sondergaard [2007]) After the crises of the 1980s and 1990s, many countries saw the solution for avoiding the crises in increasing the foreign exchange reserves, especially after the crisis at the end of the '90s, affecting Asian countries with solid macroeconomic foundations. (ENSZ [2009])

Due to the key currency role of the dollar most of the foreign exchange reserves were invested by central banks in dollar-denominated liquid assets, primarily in government bonds issued by the United States. America's privilege was realized through the low level of interest rates in the 2000s. Low interest rates supported the indebtedness of the economic actors, that is, the United States and the population thereof. In case of the former, the U.S. financed the tax reduction aiming at boosting the economy and the increasing military expenses through the increase of debt. In the case of the population over-indebtedness manifested itself through borrowings for the purpose of flat purchase, that is, the strengthening of the mortgage market and securitization. Examining the indebtedness of the United States and the reserve accumulation of the emerging countries at the level of world economy brings us to the topic of global imbalances. The Asian countries maintaining the undervalued exchange rate and the oil-exporting states accumulated significant current-account surplus at the beginning of the 2000s, which, on the one hand, lead to the accumulation of foreign exchange reserves, and on the other hand, it resulted in the indebtedness of the United States, as the "end consumer" country of the world economy. After the outbreak of the world economic crisis several analysts argued for a shift toward a multipolar system. (Eichengreen [2009], Cohen [2011], World Bank [2011])

The dissertation focuses on the events that took place in the 2000s, but the historical approach is not excluded either. Our aim is to study the world economic phenomena that can be associated with the international monetary system; in addition to the global imbalances, the economic policy of the United States, the internationalization of the euro and the renminbi

will be discussed as well. The dissertation seeks answers to the following questions. How much did the position of international currencies change in the monetary system in the period since the introduction of the euro? Will the euro or the renminbi be able to catch up to the dollar? Do the rapid economic growth and foreign trade performance of China provide suitable basis for the considerable internationalization of the renminbi? Finally we seek answer to the question whether the inertia of the monetary system after World War II, that is, whether the currency at the top of the Currency Pyramid will permanently stay there in the current world economic system.

According to the first hypothesis, the power relations among the currencies having an international role in the world economy remained basically unchanged in the period following the introduction of the euro, that is, the U.S. dollar remains the key currency in the world economy. My assumption is that in spite of the 2008 crisis originating from the United States, the emergence of the euro as a potential alternative, and the declining economic dominance of the United States the role of the dollar in the world economy remained basically unchanged in the period between 2001 and 2013. So, it is too early to speak of a diversified system.

The single European currency seemed an obvious challenger to the dollar around the 2000s. Many argued already before the introduction of the euro that the single European currency may be able to reach or even transcend the role the dollar has in the world economy in the medium term. (Portes – Rey [1998], Chinn – Frankel [2008]) The supporters of the euro based their viewpoint on the economic and export performance of the eurozone, and the anti-inflation commitment of the ECB. The eurozone is, however, at a competitive disadvantage compared to the dollar in several areas. However successful the European unification process was in the last decades, the level of European integration is far behind that of the United States. As a result of the fragmentation of the European financial markets, euro-denominated financial assets are less attractive compared to those denominated in dollars. The European foreign policy and the weakness of the international advocacy capacity slow down even further the internationalization of the euro.

According to the second hypothesis, the euro is unable to reach the internationalization level of the dollar because of the fragmentation of the economic area behind it.

As a result of the failure of the expected advance of the euro awaited by many experts and the 2010 crisis of the eurozone overshadowed the optimistic image of the single European

currency. Parallel to this, many see the main challenger of the dollar in the renminbi. The international advance of the Chinese currency is supported by the expectation that the Asian country with unbroken economic growth and gradually improving export performance following the opening at the end of the 1970s is already the second biggest economy of the world and may overtake the United States in a few decades if this tendency continues. The Chinese economy showing high rate of growth even in the period following the outbreak of the 2008 crisis has proved to be more crisis-resistant for the time being than those of the developed countries.

The deficiencies arising in the case of the euro, such as the fragmentation of the euro area and the decreasing share in global production and trade are not present in the case of the Chinese currency. The Chinese economic leadership expressly supports the internationalization of the renminbi. However, even in spite of the reforms of the past years, the financial system of the Asian country is still fairly underdeveloped, foreigners have only limited access to renminbi-denominated financial assets.

According to the third hypothesis the international role of the renminbi grew in the past years, but due to the underdeveloped state of the Chinese financial system it may only become a secondary international currency after the dollar.

2. Methods used

The theoretical framework of the dissertation is made up of the notions belonging to the definition of the international monetary system used by us, from which the notions of imbalance and international currency stand out. Apart from identifying the role the latter play in the world economy, the exploration of the conditions necessary for achieving internationalization and the advantages and disadvantages resulting from the international role, as well as the related notion of monetary power constitute the theoretical part. The concise review of the history of the international monetary system and the use of the historical experience for drawing conclusions is especially essential for examining the second and third hypotheses.

The methodology of the thesis is built on the processing of scientific literature sources and statistical data. In the case of the former, we used the works of American, Asian and European authors as well as studies by international organizations in order to achieve a balance. Regarding the quantity of expert articles written in the topic studied by us, American authors are in majority, which shows an outstanding publication activity in the topic by Americans. In the literature processed, due to the time-bound nature of the topic, the works written after the turn of the century, and from this period mainly those published after 2008 are of the greatest importance.

Concerning the statistical data, we relied on the widely used public databases of international organizations. As it was used for testing more hypotheses, the macroeconomic database relating to the publication titled World Economic Outlook should be mentioned first. World Economic Outlook, published twice a year (in the spring and in the autumn) by the International Monetary Fund (IMF) provides a comprehensive picture of the cyclical nature of the world economy and future prospects. Along with the publication of the analysis consisting of several hundred pages, the online database accessible free of charge is updated as well. The dissertation relies on the most recent data available at the time of the elaboration of the dissertation, that is, data published in April 2015. In the course of the identification of the budgetary position and items of expenditure of the United States, we used the analyses and data of the independent American Congressional Budget Office (CBO). In the case of data relating to the current account and net international investment position we use the data of the Bureau of Economic Analysis (BEA) in the United States Department of Commerce, since as the most important statistical data provider in the United States, this institution is responsible

for the compilation and publication of balance of payments statistics. For collecting data about the size of foreign exchange reserves we used the databases of World Bank and IMF. The Bank for International Settlements (BIS) provides useful information on foreign currencies used in international transactions. The organization, often called the central bank of central banks, with its seat in Switzerland, provides information on the currency composition of global foreign exchange turnover.

In the following, we highlight the most important works used for the dissertation. One of the most important international works on the history of the international monetary system is *Globalizing Capital, A History of the International Monetary System* by Barry Eichengreen, published in 2008. (Eichengreen [2008]) The author gives an overview of the history of the international monetary system between 1850 and 2008; his analysis focuses on the conflict between the completion of democracy and economic liberalization. According to one of his most important conclusions, the development of the international monetary system can only be interpreted as a historical process. The book *Exorbitant Privilege: Rise and Fall of the Dollar*, also authored by Barry Eichengreen, published in 2011 gives an overview of the role of the dollar as an international currency during a period of more than 100 years. (Eichengreen [2011]) It gives a detailed analysis of the factors that lead to the development of the world economic dominance of the dollar, the role of the U.S. currency in the Bretton Woods system, the economic policy decisions leading to the 2008 crisis, as well as the strengths and weaknesses of the current challengers of the dollar. According to the conclusions in the book, the international monetary system will develop towards multipolarity, thus the dollar has to share its “exorbitant privilege” with the euro and the renminbi. But if the United States pursues a responsible economic policy, the sudden decline of the international role of the dollar is improbable. The volume of studies by Benjamin Cohen, published in 2011, concentrates on the competition among currencies. (Cohen [2011a]) He discusses the macroeconomic and institutional reasons leading to the relative weakness of the internationalization of the euro through several articles; he finds the expectations predicting the growing of the euro into a leading key currency excessive. In connection with the future of the monetary system he finds the development of a leaderless system the most probable. We refer to several studies of the Washington based Peterson Institute dealing with world economic issues in the dissertation; publications by the Asian Development Bank (ADB) dealing mainly with the internationalization of the renminbi also provided an outstanding source.

We used Benjamin Cohen's works also for determining the basic notions in connection with the monetary power and the competition among currencies. Two volumes of studies should also be mentioned; they are *Global Monetary Governance* published in English in 2008 (Cohen [2008]) and *Future of Money*, published in 2006. (Cohen [2006]) The author deals with the issues of monetary governance, dollarization, Currency Pyramid and regional monetary integration in his works.

According to the approach also shared by this dissertation, "an international monetary system can be regarded as (i) the set of conventions, rules and policy instruments as well as (ii) the economic, institutional and political environment which determine the delivery of two fundamental global public goods: an international currency (or currencies) and external stability". (Dorrucci – McKay [2011] pp. 9.)

For testing the first hypothesis, we took the functions of international currencies in world economy as a starting point. International currencies fulfil the traditional functions of money, that is, they function as medium of exchange, unit of account and store of value. Although the literature stresses only the reserve asset role of the currency in many cases, it should be highlighted that an international currency is not only used by official actors, but also by the private sector in various transactions. A distinction has to be made between the notions of reserve currency serving as store of value, which refers to the assets accumulated by the central banks, and international currency, which analyses the international role also in terms of financial relations between actors of the private sector. The unit of account function relating to governmental use refers to the anchor currency role of an international currency, that is a foreign government or central bank may peg the exchange rate of a national currency to the given currency in order to ensure stability. The third function relating to governmental use is the function of medium of exchange for conducting foreign currency market interventions, that is, the use of foreign exchange reserves. The store of value role used by the private players includes the possibility of borrowing and providing loans in foreign currency. In order to ensure conversion between two low liquidity currencies, a third high liquidity currency will be inserted in order to carry out the transaction, which further increases the medium of exchange role of the international currency for the private sector. Finally, the unit of account function plays an important role in settling commercial transactions. On a theoretical level, in connection with commercial transactions, the unit of account and the medium of exchange functions should be distinguished, as determining the prices and actual payment may be made using different currencies. For instance, the countries along the Persian

Gulf determined the price of the oil in USD until 1974, but the actual payment was made in GBP. (Krugman [1984])

For testing the first hypothesis, the concentration of the international monetary system can be measured with the help of the concentration ratio (CR) and the Herfindahl-Hirschman Index. The former can be regarded as a general indicator which can be used to describe both absolute and relative concentration. It shows how much share the few units selected from a multitude have from the total sum of values. As opposed to this, the Herfindahl-Hirschman Index can be defined as the sum of squares of the shares the units have from the sum of values (that is, sum of squares of relative sums of values).

$$H = \sum_{i=1}^N s_i^2$$

In the above formula s_i stands for the relative sum of values while N represents the number of units. The minimum value of the Herfindahl-Hirschman Index is 1, which means perfect concentration. If N is given, the minimum is $1/N$, which is achieved if the share of all units is the same. One great advantage of the index is that it takes into consideration the number of units as well. So, if, for instance, the sum of values is evenly distributed among 100 units, it gives a smaller value than in the case of 10 units. So the Herfindahl-Hirschman Index gives the arithmetic average of the shares of the sum of values weighted with themselves. As a result, the smaller units have less weight, while the larger units have more weight, so the index is especially sensitive to large units.

The starting point of proving the second and third hypotheses is determining the conditions necessary for the internationalization, discussed in detail in the theoretical part. In the following, we describe the test criteria for the purpose of giving a summary. The economic performance of a given national economy creates the condition for a currency to become more attractive for the foreign economic players thanks to the lower transaction costs in international economic relations. (Eichengreen - Frankel [1996], Subramanian [2011]) Regarding the trust in the international currency as store of value, one important factor is the stability of the currency. (Cheng – Peng – Shu [2009]) In order for a national currency to become a key currency, a national economy's stable macroeconomic performance and leading position in world production or a position close thereto is not enough. These two conditions can be considered necessary but not sufficient. The state providing the key currency has to have open, deep, liquid and crisis-resistant financial markets, including as essential conditions

capital market liberalization and full convertibility of the currency. The liquidity of financial markets primarily refers to the liquidity of the secondary market of the government securities, as foreign central banks accumulate their international reserves in the form of government bonds.

The trust in the lasting stability of the currency is one of the bases of the trust in the issuing state as political unit. The latter can be provided by a strong, centralized state, which guarantees long-term political stability through which sustaining monetary stability becomes easier, too. (Lim [2006]) The historical experience according to which only monetary unions supported by political unions can survive permanently, highlights the importance of political stability. The reason for this is that different shocks can affect the member states differently, so the political will to sustain the monetary union may weaken. Another condition is connected to the political system, according to which the trust in the different set of rules and institutions should be of high level, and contracts should be definitely enforced. The foreign policy relations of the country and the international advocacy capacity of the state affect especially the governmental use of the international currency as unit of account. The tighter the relationship with the leading power of the region, the greater the incentive to link the exchange rate of the international currency to the currency of the dominant country. (Li [2003]) Eichengreen [2007] highlights the importance of the state support of the internationalization of the currency, which played an important - but not vital - role in achieving a leading role in the world economy in the case of the British pound and the U.S. dollar.

In relation to foreign policy relations, Posen [2008] stresses the necessity of the military power and dominance of the state providing the key currency, thus concentrates on the safety dimension of international relations. He emphasises that the safety guaranteed by the dominant power may motivate the states accumulating central bank reserves, so in addition to narrow economic factors they take into account military, defence policy aspects when making a decision about the foreign currency composition of their reserves.

3. Results of the thesis

3.1. Concentration of the international monetary system

In four out of the six roles of the international currencies discussed in the theoretical part, we evaluated the evolution of the concentration of the international monetary system between 2001 and 2013 using statistical methods. Below we present our most important findings.

In terms of foreign exchange market turnover, the dominance of the dollar somewhat decreased between 2001 and 2010, then it approached the 2001 level again in 2013. From the currencies representing more than ten percent, the euro, the Japanese yen and the British pound follow the dollar from far behind. According to the data of the European Central Bank, in terms of the international currency function, euro was able to get close to the dollar between 2001 and 2007, then the gap between the two widened again in 2008. The American interest rate sinking to a record low level in 2008 encouraged the indebtedness in the U.S. currency, while the crisis of the eurozone put a brake on international borrowings in euro. Furthermore, it should be mentioned that the weight of the Japanese yen fell to less than its third in the period examined.

In connection with the foreign currency composition of the foreign exchange reserves, we concluded that the weight of the dollar somewhat decreased between 2011 and 2013, but it remained above 60%. After a slow increase, the role of the euro reached its peak in 2009, then stabilized at 24-25% between 2011 and 2013. The increase of the ratio of the other currencies to five times suggests that some diversification took place in the past years, but the assets denominated in dollar and euro still constitute approximately 85% of the reserves.

We summed up the three aspects examined by us first with the help of the concentration ratio. In each of the three cases the decrease of the degree of concentration can be observed between 2001 and 2013, but the decrease is minimal. Even in the case of the foreign exchange reserves with the largest decrease, the almost exclusive, 98.7% share of the five most important national currencies in 2001 dropped only to 93.5%.

Our conclusions do not change significantly, if we examine the concentration with the help of the Herfindahl-Hirschman Index. In the case of the foreign currency market turnover the concentration remained virtually unchanged, while some increase could be observed in the case of the international securities as a result of the increase of the weight of the dollar. As a

result of the slight decline of the U.S. currency and the increase of the role of the smaller currencies, concentration decreased in the case of the foreign exchange reserves, but not to a dramatic extent.

According to the IMF's classification, in 2013 44 countries pegged their currency to the dollar, while 27 countries to the euro. Another 22 countries pegged their currency to another currency or a currency basket consisting of several currencies. The dominance of the dollar is more significant than it initially seems to other countries, as there are considerable differences among the economic weight of the countries fixing their currency. Countries using the dollar as anchor currency constitute 55.9% of the aggregate GDP of countries using the exchange rate as nominal anchor, while in the case of the euro, this number is only 14.4%.

Based on the described time series and the concentration indices used we consider the opinions according to which the international monetary system is becoming multipolar premature. In the period between 2001 and 2013 the relative weight of the major international currencies did not change significantly; the dollar is still the key currency of the world economy, followed by the euro from far behind. Of course, this does not exclude the possibility that this system will shift toward one based on several currencies with approximately the same weight in the near future.

3.2. The euro as a rival to the dollar

For testing the second and third hypotheses, we examined the factors that weaken or strengthen the international role of the euro and the renminbi based on the aspects compiled in the table in the theoretical part. In connection with the potential related to the internationalization of the euro, we can conclude the following. The share in global production and trade essential for exploiting the advantages of economies of scale can provide the basis for the world economic role of the single European currency, exceeding the current role. However, if we take into consideration the slow economic growth of the eurozone in the last decades, the decrease of its world economic weight, and the future prospects, it is improbable that the economic performance of the euro area alone could increase the international role of the euro. Not only the relatively favourable productivity, but also the optimistic view of the future related to the economic performance is necessary for strengthening the trust in the currency.

It is the protection of the purchasing power of the currency in connection to which the euro area approximates the performance of the dollar; the ECB successfully reached its goal set out in legal regulations in the period since 1999. It should be highlighted, however, that the ECB exists only since 1998, while the Fed was founded a century ago. And accumulating credibility takes time. Another disadvantage in relation to the central bank is the neutral role of ECB in facilitating internationalization.

While the financial markets of the eurozone can be considered developed on their own, as a result of their fragmentation they are unable to provide assets with liquidity similar to the American markets, which is traceable in the case of the market of government bonds especially important for strengthening the international role. The weakness of the integration of the European Union hinders the strengthening of the global role of the euro in other fields as well. The Union is unable to speak with one voice in the international financial organizations, the diverging interests of the member states hinder collective action. The institutional deficiencies negatively affect other areas as well, as a result the euro was unable to make substantial progress compared to the nineties in connection with the currency peg also influenced by safety and geopolitical relations, which reflects both the lack of a unified foreign policy and the weakness of the military forces of the EU. The quality of the member state level government showed no convergence either in the period following the introduction of the euro. (Benczes - Rezessy [2013]) As Cohen [2011b] also highlighted it, currently, the euro is a currency without a country, it is not an expression of a unified, sovereign power but the result of an international agreement, which prevents it from playing a role more dominant than the current one in the international monetary system.

The current presence of the above hindering factors does not necessarily mean that the international role could not increase in the long run as a result of targeted reforms. With the progress of the financial integration there is a possibility for creating an at least partly integrated government bond market, which may increase the attractiveness of the European financial assets. With sustainable structural reforms and fiscal policies, the rate of potential economic growth may be increased. Further integration in the field of foreign policy may increase the effectiveness of the EU's actions in international policy and financial matters. However, even after the implementation of the listed reforms it cannot be expected that the euro will have a role similar to that of the dollar in the world economy.

3.3. The renminbi as a rising international currency

As a result of the permanently high rate of Chinese economic growth resulting from the economic reform process in China from the '70s, today China is the second biggest economic power and leading exporter of the world. The Chinese currency, however, has not played international role for a while, which is mainly the result of the capital controls in relation to the undervalued exchange rate connected to the economic model. As the financial regulations became less strict and steps supporting the internationalization of the economic policy were taken in 2008, today the renminbi can be regarded as an elite currency using the categories of Cohen's Currency Pyramid, as its international role increased significantly from its low base in the past years. According to most of the studies we consulted the Chinese currency may increase its international role.

But there are considerable hindrances to the further increase of the world economic role of the Chinese currency. In the course of the internationalization that took place so far based on the Chinese export performance, the rate of Chinese export in renminbi increased significantly, but the leading international currencies are used also in the trade transactions of states using two different currencies, which is not visible in the case of the renminbi yet.

According to Eichengreen [2011], the euro is a currency with too little state, while in the case of the Chinese currency the state intervention hinders the progress of internationalization. On the one hand, the Chinese political system does not support the building of long-term trust in renminbi assets, the dictatorial political system and the lack of rule of law may decrease the interest of foreign economic actors in Chinese investments in the long run. Great Britain, the United States, Japan and Germany all had democratic political systems in the period of growing internationalization of their currency, even the countries issuing second-rate currencies under the current world economic conditions are all democracies. The opinions, according to which the Chinese currency can reach the level of internationalization of the euro or even the dollar disregard the fact that after becoming an elite currency it is much harder to reach the level of a patrician currency or a top currency, as the case of Japan at the end of the '80s shows. Going downwards in Cohen's Currency Pyramid there is space for more and more currencies, while going upwards, we can find fewer currencies. On the other hand, the underdeveloped state of the Chinese financial system and the capital controls still hinder the internationalization of the renminbi. In spite of the slow reform process of the past years there was no breakthrough regarding de jure openness, and also the Chinese de facto financial

openness stagnated in the past years, if the latter is calculated as the ratio of the sum of foreign assets and liabilities to GDP.

4. Summary of conclusions

In the theoretical part of the dissertation we discussed several topics in connection with the functioning of the international monetary system. In subsection 1.3 we gave the definition of the international monetary system, then, in the next subsection, we determined the conditions for the internationalization of the currencies, which we used for testing the second and third hypotheses. Following that, we dealt with the advantages and disadvantages related to the international role, and the concept of monetary power. In chapter 2 we examined the history of the international monetary system between the middle of the 19th century and the 1990s. In section 3 we pointed out through the examination of the high rate of currency reserve accumulation, global imbalances and the economic policy of the United States that the top currency status of the dollar contributed to the development of the global economic crisis that broke out in 2008.

In connection with the first hypothesis we established using statistical methods that although the concentration of the international currencies playing a role in the monetary system slightly decreased between 2001 and 2013, the dollar is still the key currency of the world economy. So nowadays we cannot speak of a diversified international monetary system; the world economy is still characterised by one top currency.

Regarding the second hypothesis we established that since the eurozone is not a unitary state but a monetary zone including 19 countries, the euro is unable to go beyond the role of patrician currency. On the one hand, the lack of unity in action and of a unified foreign policy hinder lobbying in international organizations and in foreign relations in general. On the other hand, although the financial markets of the eurozone can be regarded as developed, the lack of a unified bond market renders them unable to approach the liquidity of the government bond market of the United States.

Upon discussing the third hypothesis we highlighted that the authoritarian nature of the Chinese political system and the deficiencies of the rule of law may hinder the foreign investors from having trust in Chinese assets. In addition, the underdeveloped state of the Chinese financial system puts a brake on the internationalization of the renminbi in the long run. With regard to de facto financial openness, China has considerable disadvantages compared to the other countries issuing international currencies, while despite numerous

liberalization measures it failed to achieve a breakthrough in connection with de jure openness in the past years.

Thus, the dominance of the dollar after World War II will last in the near future as well, which is a result rather of the lack of alternatives from the '70s than of the prudent economic policy of the United States. The subsistence of the status quo is also a reflection of the inertia of the international monetary system, that is, of the fact that if a national currency obtains an international leading role, significant changes in the international politics and economy are needed for another currency to take over its role. The changes mostly come in the form of shocks. Thus, the development of the hegemony of the dollar cannot be explained without World War I and World War II. The 2008 crisis starting from the financial sector of the United States has not undermined the trust in the dollar, as some would have expected, so it did not cause as big a shock as the World Wars or the Great Depression in 1929 for the international monetary system.

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