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Book review: The Dollar Trap

We are now on territory neither inviting nor catchy. But the author who is the Tolani Senior Professor of Trade Policy at Cornell University, USA, knows his onions and delivers 'solid knowledge' with a grace and simplicity that's tailormade for non-specialist readers. For example, the first lines of the preface say with self-explicit grace and simplicity:

"The US Dollar reigned supreme in global finance for most of the twentieth century. In recent years its position on that pedestal has seemed increasingly insecure. The creation of the euro in 1999 constituted a major challenge to the dollar but that challenge has faded. The global financial crisis which had its epicenter in the US heightened speculation about the dollar's looming, if not imminent, displacement as the world's leading currency."

Prasad argues such conjecture was premature and that the global financial crisis has strengthened the dollar's prominence in global finance. He goes on to explain how and why the dollar's roles as a unit of account and a medium of exchange might well erode over time. Having said so, one must not neglect the possibility that one day sooner rather than later, it might become easier to denominate and conduct cross-border financial transactions directly using other currencies without the dollar as intermediary. Should this happen, it will reduce the need for the dollar.

In contrast, adds Prasad, by way of esoteric argument, the dollar's position as the foremost store of value will still be very secure. Why? Because financial assets denominated in US dollars, particularly US government securities, will remain the destination for investors interested in the safe-keeping of their investments.

To keep his book reader friendly, Prasad has divided it into four parts: Setting the Stage, Building Blocks, Inadequate solutions and Currency Competition. These might seem pretty fuzzy at first sight but such obscure section titles are inevitable given the wide range and scope of a book on macro economics. However, what earns the author kudos is that he chose to ask and then answer with clarity, shunning heavy theoretical stuff altogether, questions on issues like what is special about the dollar, the paradox of uphill capital flows, the quest for safety, seeking a truce on currency wars, and whether the dollar could hit a tipping point and sink. Reading this book is probably like attending one of Prasad's seminar classes at Cornell where he starts off on a long, dull and dry topic and miraculously makes the class enjoyable!