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Military and Political Influence on the Portfolio of Global Reserve Currencies

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ABSTRACT

This paper analyses a new concept presented in the works of B. Eichengreen, A.J. Mehl, L. Chitu "Mars or Mercury? The Geopolitics of International Currency Choice", according to which the state's possession of nuclear weapons is linked to its possession of reserve currency. The paper **aims** to provide a detailed assessment of how gaining reserve currency status depends on the military and political potential of the state issuer. The research **method** is an analysis of the historical material and the current state of the issue under discussion. The study shows the relationship between the global military and political leadership and control over the global financial infrastructure, which increases its importance as a space for interstate conflicts. It has been proven that neither the presence of military power nor the ability and willingness to provide partners with security guarantees do not predetermine the acquisition of the reserve status by the national currency. This status is acquired as a result of control over global investment processes, in the implementation of which military power plays a significant, but not exclusive role. This power, as the potential for economic and financial dominance, is a derivative of the scale and level of development of the national economy, with a key factor in its deep involvement in international trade. From the point of view of practical forecasting of economic, military and political development, the authors **conclude** that in the foreseeable future, despite the strengthening of its military potential, the PRC will not be able and, most likely, will not try to obtain the status of the yuan as a reserve currency. The United States, in turn, will increasingly use its dominance in the capital market and control over the global financial infrastructure as a tool to maintain global leadership. Further study of the considered issues will significantly increase the efficiency of forecasting economic processes in relation to the military and political situation.

Keywords: reserve currency; the cost of financing the budget deficit; international trade; global financial infrastructure; economic, military and political domination; nuclear weapon; "Mars hypothesis"; "Mercury hypothesis"; "Athena hypothesis"

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INTRODUCTION

The paper "Mars or Mercury? The Geopolitics of International Currency Choice" by B. Eichengreen, A. J. Mehl, L. Chitu from the National Bureau of Economic Research [1], is particularly valuable and relevant now in a situation of simultaneous multilateral exacerbation of contradictions between states. With regard to assessments of long-term reserves and the state of international trade, the material collected by these authors is more than complete. However, when assessing the military-political interaction and the processes of capital movement and international trade associated with it, they demonstrate the limited data used and the lack of experience in economic analysis of such problems. Compensation for such incompleteness will make it possible to more accurately assess the dependence of the acquisition of the reserve currency status by the national currency on the military-political potential of the issuing state.

THE INCOMPLETE SCOPE OF RESEARCH

The mention of the nuclear weapons as a factor providing greater security and, as a consequence, facilitating the choice of a reserve currency, rests

on the incompleteness of the list of states provided by B. Eichengreen, A. J. Mehl, and L. Chitu for which the presence of a nuclear missile potential cannot be unambiguously attributed to the tightness of economic relations with the United States. Countries like Germany, Japan, and Saudi Arabia are non-nuclear powers, but for the first two countries, the US market is of paramount importance, and Saudi Arabia initially looked for markets to place its giant financial assets, which meant turning to the largest of these markets — the United States. However, this thesis makes the list of countries cited by the authors much more controversial due to the changing factors affecting their security. Chronologically, the gap between the analyzed data from a military-political point of view is too large — between 2004 (data for the UK) and 2016 (data for Russia), a whole epoch passed, including the relations between these two powers, which directly influenced their security, and their economic (including trade and financial) policies.

The assessment of the nuclear potential for all the states under consideration clearly does not reflect the real situation with ensuring security, including on the ground of an independent nuclear missile potential. The UK, although a nuclear-weapon state, is at the same time the closest military ally of the United States and critically depends on them in the production of both thermonuclear charges and their carriers. Thus, in the ranking of nuclear powers, it has the least independence, which should have put it in first place in terms of the share of the US dollar in reserves, but in practice, it is in last place.

Israel's nuclear weapons program is independent, but its dependence on the United States for security, both in the provision of concessional loans for the purchase of U.S.-made weapons and military equipment and in the direct security guarantees, is very high and cannot be compensated for the possession of nuclear missile weapons due to the small size of the territory.

India is not officially an ally of the United States, but as of 2015, analyzed by the authors in relation to this country, it was rapidly moving closer to Washington in security matters. Political-military relations between the United States and China in 2008 were rather wary, with the Russian Federation in 2016 — obviously unfriendly.

Based on the concept proposed by the authors of the dependence of the choice of the reserve currency on the country — the guarantor of security, the less the country depends on the security guarantees of the United States, the less is the share of the currency of the guarantor country in its reserves. Accordingly, the rating for nuclear-weapon states should look as follows (in descending order of dependence):

- United Kingdom.
- Israel.
- India.
- China.
- Russia.

The figure presented by the authors looks different (in descending order of the share of the US dollar in the foreign reserves), which does not allow us to reveal the correlation of the two factors:

- Israel.
- India.
- China.
- Russia.
- United Kingdom.

The indicators on the share of the US dollar in the reserves of Russia and the UK are very close, as well as China and India, with a completely incomparable level of their military and political contradictions with the United States, make a hypothesis about the role of nuclear weapons vulnerable. The lack of data on such nuclear powers as France (as the authors point out) and Pakistan (they do not mention it) should be considered.

Non-nuclear powers are more homogeneous because the United States plays a key role in ensuring their security. However, the authors are faced with the problem of the anachronism of their data. They argue that the United States initially guaranteed the safety of Germany from the USSR and Japan from China. For 2006 and 2004, according to the authors, this is true, but before the collapse of the USSR, it was considered the main threat to Japan both by this country and by the United States. China did not have the potential and ground for an invasion of the Japanese archipelago.

At the same time, from 1987 to 2014, Germany did not consider the threat from the Russian Federation to be real not only for itself but also for the stability of its allies and partners. The threat to South Korea (from North Korea) and Taiwan (from China) seems constant and very serious. The threat to Saudi Arabia has less opportunity, given the potential of the Islamic Republic of Iran (IRI), to develop into an open full-scale military conflict. Thus, if the size of the reserves in the currency of the guarantor country (USA) was directly dependent on the role of this country in ensuring security, the list of non-nuclear states would look in descending order of dependence on ensuring security, as follows:

- Taiwan.
- South Korea.
- Japan.
- Saudi Arabia.
- Germany.[1]

The list presented by the authors looks as follows (in descending order of the US dollar's share in foreign reserves):

- Saudi Arabia.
- Germany.
- Taiwan.
- Japan.
- South Korea.

There is no correlation either; rather the opposite. Thus, from the point of view of the role of the issuer of the reserve currency in ensuring security, the hypothesis also looks unconvincing. The ranking of the US role in the trade of the states under consideration, in our opinion, is more clearly related to the choice of the reserve currency.

Regarding the choice of currencies, conditionally claiming reserve status before World War I, the currencies of the leading Entente countries (except for Russia), Germany and Holland are mentioned. The latter remained neutral and, most importantly, did not have significant military weight. Its neutrality ensured the well-being of the Dutch economy and the strength of its currency *after* the war, but *before* the war it weighed no more than the neutrality of Belgium and Luxembourg, which Germany violated in the first hours of the war. Moreover, during the next world war, Holland shared the fate of Belgium, although even then it counted on maintaining its neutrality. Thus, the choice of the Dutch guilder is not obvious — from a military-political point of view, Russia, Austria-Hungary, Italy, and Turkey had immeasurably greater military weight among the belligerent powers (in descending order). Among the neutral countries are Switzerland and Sweden, which could ensure their neutrality and ensured it during both world wars. Thus, the Dutch guilder can act as an element of comparison in relation to the "Mercury hypothesis", but not to the "Mars hypothesis", while the task of the study is a comparison of both hypotheses.

In general, the choice of the analyzed countries from the point of view of both economic and political realities before the World War I is doubtful. Among the dominions, Australia and Canada did have noticeable economic independence, and Canada was already clearly showing a tendency to move towards the US economic influence. The forces of the dominions were small from a military point of view. However, India, Indonesia, Sri Lanka were full-fledged colonies. It will be shown below that the key importance for the formation of military-political alliances of that time was played not so much by international trade itself as by the movement of capital. Britain took the lead in this process and from 1870 to 1914 invested abroad almost half of its domestic savings, interest, and dividends, which were 1/10 of its national income. At the same time, the ratio of British investments in the territory of the empire (including formally independent Egypt) to investments in other countries was approximately 6 to 5 [2, p. 243]. Obviously, with such a massive inflow of capital denominated in pounds sterling, the reserves of the colonies in full, and of the dominions — to varying degrees — were ultimately formed on the basis of the policy of the metropolis, which also determined their foreign trade activity.

The same applies to Finland, which was part of the Russian Empire. The Philippines in the analyzed period ceased to be a colony of Spain

[1] Saudi Arabia and Japan can switch places if we assess not the potential of a potential adversary, but the likelihood of deteriorated relations.

and, having formally gained independence, in fact, remained a protectorate of the United States. Even Norway remained in union with Sweden until the middle of the period under consideration. With the approach applied by the authors, they should have separately considered Austria and Hungary (as part of a two-pronged monarchy) and, possibly, the Czech Republic.

Thus, out of 19 countries under consideration, 6 cannot be considered in the "Mars hypothesis" at all (without having an independent military potential, but enhancing the potential of the metropolis) and to varying degrees, can only be partially considered in the "Mercury hypothesis" (without having a sovereign economic, let alone financial policy). If we add two dominions to their number, then the number of non-representative territories (which in one way or another were not subjects of politics) increases to 7. As for Brazil and Chile, they had no interest in World War I.

Of the remaining 10 states, Japan's accession to the Entente was predetermined precisely by the "Mars hypothesis", since the country's navy was largely staffed with ships built by Britain and the United States. In addition, Japan had no interests in Europe, where the main theater of military operations was located, and could reasonably count on easily seizing isolated German colonies in China (which it successfully carried out). Japan's military efforts ultimately remained minimal.

As a result, from the above list, the following countries could *independently* influence the course of World War I: Austria (more precisely, Austria-Hungary), Germany (as the Axis powers); Russia, Italy, Romania, and Greece (as the Entente powers); Sweden, Norway, and Switzerland (as neutral powers). The choice is clearly incomplete in terms of the importance of states for the military-political situation before and during the First World War (primarily due to the absence of its important participants — Serbia, Belgium, and Turkey, as well as neutral Denmark, which played a significant economic role). This is no less illogical from the point of view of the security (as an influence on the choice of the reserve currency). For colonies and protectorates, this was predetermined and was not a choice by itself. Japan had serious treaty guarantees from Britain but did not have them from other major powers of the Entente until the very beginning of the war. Moreover, relations with Russia were very complicated by the relatively recent war of 1905. The guarantees of Austria-Hungary and Germany were mutual, although the superiority of the latter (both economic and military) was noticeable, until 1916 the role of Vienna in military plans of allies was independent. Italy had guarantees not from the Entente, but from the Axis powers before the war, of which it was a formal member, and its entry into the war in 1915 was viewed by Vienna and Berlin as a betrayal of its obligations. Romania did not join the Triple Alliance[2] just because Bismarck considered it unnecessary, but according to the 1889 agreement (extended in 1892 and expanded in 1900), it was allied with Austria-Hungary, to which Germany joined in a separate act.

Greece joined the Entente in June 1917, but in reality, it was a desire to work its way towards the implementation of territorial claims against a weakened Turkey. By that time, if not defeat, then the impossibility of victory for the Axis powers had already become obvious.

Norway, while not participating in the war, actually acted as a non-belligerent British ally due to its vulnerability to the British navy and its dependence on exports to the UK.

Sweden experienced some pro-German hesitation at the start of the war but quickly opted for neutrality. Switzerland did not even doubt its neutrality. Of these neutral countries, only Norway received any guarantees during the war. In general, the foreign and defense policy of the three Scandinavian countries before World War I exactly reflected the state of their investment markets. Relying on foreign investment, Denmark tossed between the Axis and the Entente powers, completely oblivious to the possibility of resisting potential aggression. Norway, where foreign investment played an important role, relied on a strong ally, hoping with its help to repel any aggression attempt if any. Sweden, with little

[2] Pointing out that it was a formal, albeit secret, member, the authors are not entirely correct, with regard to Romania, there was a system of separate bilateral agreements.

foreign investment, was self-reliant and willing to play an independent role in a future conflict.

With regard to the analyzed countries, the pound sterling, if we proceed from the position of the authors, should have dominated purely quantitatively, since out of the total number of them, 4 of these territories were under the direct political control of Britain (albeit with very different degrees of autonomy), and only one was controlled by the Netherlands, the United States (formally independent Philippines), Sweden (Norway until 1905) and Russia (Finland until 1918). The territories on this list controlled by Britain were immeasurably superior to those controlled by the other countries mentioned in terms of population, area, and volume of production. At the same time, the currencies of Russia and Sweden are not considered by the authors as reserve ones. Probably, if the list had included the overseas territories that Germany and France had at that time, the conclusions made by the authors would have changed. The authors themselves point out the importance of colonial status for the choice of a reserve currency, but the very concepts of choice and reserves are questioned — the choice was clearly not free, and the goals of the reservation were fundamentally different from those of sovereign states. Likewise, the functions performed by the colonial authorities responsible for financial regulation were different.

Nevertheless, the great merit and observation of the authors lie in the choice of the pre-World War I period for the analysis. This period demonstrates the direct dependence of military-political alliances on the international movement of capital, but not in terms of the choice of a reserve currency or international trade in general, but in terms of ensuring public loans and international trade in in arms and military equipment.

FINANCIAL ASPECT OF INTERSTATE ALLIENCES

The direct connection between state loans and the formation of military-political alliances before World War I is especially noticeable in the example of France, which acted as the center of Entente alliance, which was based on the two concluded agreements — with Russia and Britain, only later they were formalized into a general alliance. Its formation was largely facilitated by France's special position in the international borrowing market. It is characteristic that this leadership ultimately led both to the militarization of the national economy and a relative lag in the development of the industry. In 1872, France exported capital in the amount of 10–12 billion francs, in 1900–30 billion, in 1914–60 billion, i.e., the export of capital increased 6 times, and industrial production — in 3 times [3, p. 518]. According to 1908 data, 9.5 billion francs were invested in French industry and trade, and 10.4 billion francs in bonds and other foreign stocks, i.e. 10 times more. At the same time, taking the military expenditures of France in 1913 per capita as 100%, for Britain this figure was 82%; Germany — 72%; Italy — 40%; Austria-Hungary — 22%; Russia — 32% [3, p. 341]. If, as noted above, British investments were mainly productive, then the French were directly focused on public debt. In 1902, 55% of French capital invested abroad was invested in state and municipal loans, and only 25% was invested in the industry and transport of foreign countries (while 40% of French capital investment in Europe was in Russia) [3, p. 519]. Undoubtedly, the main impetus in France's military preparations was the desire to avenge the results of the Franco-Prussian war and fears (which motivated its future allies) of the strengthening of Germany, but this was precisely an exceptional opportunity, including infrastructure, in providing government loans that put Paris at the center of the future coalition.

The very beginning of the formation of two opposing coalitions in Europe was directly related not only to trade contradictions but also to direct government pressure on the possibility of borrowing a negotiating partner. Thus, the agreement between Russia and Germany, known as the "reinsurance contract", concluded in June 1887 and providing for three-year mutual neutrality (except for cases of aggression against Austria-Hungary and France), was not extended and did not turn into an alliance largely because that the greatest irritation in Russia was caused not by openly provocative attempts to push Russia into

a war with Great Britain for the Black Sea Straits, but by Bismarck's "advice" to German banks to ease the burden of Russian assets motivated by the instability of Russian finances. Bismarck's financial pressure not only failed to achieve its goal, but also had the exact opposite result — the Russian government turned to France for support, and in 1888 French banks provided Russia with the first loan in the amount of 200 million francs. The strengthening of the Franco-Russian alliance was accompanied by a grandiose operation of 1888–1889 on the conversion of Russian public debt on the Parisian money market [4, p. 97]. And when at the initial stage the Russian government showed hesitation, the French Rothschilds immediately refused it a loan. 75% of government loans from Serbia, Bulgaria, Romania, and Greece were also placed on the Paris Stock Exchange [3, p. 520]. Of the four indicated countries, three, despite hesitations, ended up in the Triple Entente, and Russia, together with France, became the first participants in this bloc at the stage of its formation.[3] In 1913, at a meeting of the General Staff, representatives of France announced that the Russian government could provide annual loans on the Paris Stock Exchange only if the construction of strategic railways began immediately [5, p. 309].

The formation of an alliance around Germany was also directly accompanied by a sharp increase in the expansion of German capital. After a German military mission aimed at reorganizing the Turkish army, the German capital began to infiltrate Turkey in 1880. In 1888, German banks received a concession for the construction of the Anatolian railway with a length of 500 km (this branch was the beginning of the famous Baghdad railway, the construction of which finally connected Turkey with Germany) [6, p. 428]. Nevertheless, Germany's potential was significantly inferior to the capabilities of its future adversaries — in 1914 German foreign investment was already 35 billion marks — this was half the corresponding figure for Britain and 2/3 for France [7, p. 86]), which predetermined, despite diplomatic successes, the gradual reduction in the number of its future allies.

Although Italy was initially an open member of the Triple Alliance, gradually it was economic, and primarily financial pressure from Britain and France, which forced it to change its position. Since the Italian economy was highly dependent on imports (in particular, up to 25% of consumed raw materials and almost all coal was imported), Britain quickly demonstrated to Italy that it had no choice by stopping coal exports to the Apennines for only a few weeks, which led to the collapse of the industry, panic in the banking sector and rising prices [8, p. 421]. The instruction to the French ambassador in Rome from Foreign Minister Ribot contains a direct indication of the inextricable link between interstate borrowings of that time and the formation of military-political alliances: "Our policy is to be good with Italy without harming her, but no loans to her until she is convinced of the futility of her alliance with Germany and Austria-Hungary".[4]

The situation in Russia before World War I is worth mentioning separately since there was a serious contradiction between the level of military power and the provision of capital. The dependence of the military-political course of St. Petersburg on external funding manifested itself already in 1905, when Germany, taking advantage of the exacerbation of Russian-British relations, tried to separate Russia from the Entente and form a military alliance with it. Although Germany managed to impose a much more favorable trade agreement on Russia, the conclusion of an alliance, which Nicholas II personally spoke about a lot, was rejected because of the report of the Minister of Finance Kokovtsev, presented at the very moment of negotiations [9, p. 605]. It said that the use of three money markets available to Russia — Paris, Berlin and Amsterdam — would allow borrowing up to 500 million rubles during 1905, which would cover the needs of 8 months of the war. Of these, the Berlin market could give 231 million rubles, for which they have already begun to sell a loan (funds in small portions were received throughout the next year). The remaining 270 million could

[3] This treaty (from French "entente" — meaning "friendship, understanding, agreement") was originally built upon the Franco-Russian alliance and the Entente Cordiale of 1904 between Paris and London later.

[4] Documents diplomatigues français, série I, Vol. VIII, No. 183.

be obtained only in Paris. At the same time, the usual budget was planned with a deficit of 400 million rubles. Paris responded to all attempts at rapprochement with Germany with blows to Russian finances, and immediately compensated for the conclusion of the above trade agreement with an agreement on the transfer of Russian military orders to France, and they were carried out at prices higher than German ones.

In 1900, 1,736.8 million rubles of Russian share capital, 911 million rubles were accounted for by foreign investors. Of the total amount of foreign capital invested in Russian industry, Belgium, France, and Britain (i.e., the Entente countries) accounted for 660.7 million rubles, and German capital — 97.9 million rubles. [5, p. 170]. The capital of the Entente countries was concentrated in strategic industries — mining and metals production and oil.

The above figures very well explain the hesitation of Russia between Germany, to which it was pushed by dynastic considerations and personal sympathies of the emperor Nicholas II, as well as the very noticeable interests of both exporters and importers of industrial and agricultural products, and France to which it was pushed in the first place by the interest of capital imports, mainly in the form of government loans. The final choice of St. Petersburg explains these figures. Germany could supply Russia with any goods — consumer goods, machinery, equipment, weapons, and military equipment, and could buy a significant part of Russian raw materials. Russia needed it to a much greater extent than France, and especially Great Britain, which had huge empires. But Germany, which itself experienced (albeit for other reasons) a relative lack of capital, was physically unable to finance the Russian public debt in the required amount. This forces us to look at both the "Mars hypothesis" and the "Mercury hypothesis" from a slightly different angle than the authors.

Separately, United States should be mentioned, whose accession to the Entente powers[5] finally deprived Germany not only of hopes of victory but also of the opportunity to conclude peace on the basis of the pre-war status quo. The United States was not a major exporter of capital until World War I, and its investment presence in Europe was negligible. If British foreign investment amounted to $ 20 billion, French — $ 10 billion, German — $ 5 billion, the United States — only $ 500 million. More than 88% of them were in the countries of the North American continent (mainly Canada and Mexico.), in Europe (without Russia) — only 2%, i.e. only 2 times more than for Japan and China combined [10, p. 566]. But this by no means refutes the above assumptions about the key role of government loans both in the process of forming military-political alliances and in obtaining the status of a reserve national currency. While not a major exporter of capital, the United States was a major importer of capital until World War I. By 1899, foreign investment in the US economy reached $ 3.3 billion, of which $ 2.5 billion fell on British banks [10, p. 566]. That is, just as government loans pushed St. Petersburg to Paris, private investment pushed Washington to London. In the course of the war, the situation changed, and the United States began to turn into a creditor and supplier of the Entente (since the delivery of goods to Germany would require a challenge to the superior forces of the British fleet blocking it, as well as a preference for a less solvent partner). In total, during the period of United States neutrality, Britain, France, Italy, and Russia received about $ 2 billion from the United States, and Germany — $ 20 million [10, p. 566]. In this case, as we can see, the movement of capital, as in relation to Russia, fully explains the choice of a military-political alliance. However, the different nature of interstate economic relations leads to the fact that with a smaller purely military potential, the United States received an incomparably higher status of the national currency as a reserve than in the case of Russia.

From the above, it can be seen that security guarantees hardly predetermine the choice of the reserve currency. Quite the opposite. In an effort to provide security guarantees through the creation of military-political alliances, states with

[5] The United States was not an official member of the Entente powers, acting as an "associated member".

significant capital (especially if their infrastructure was focused on the export of capital with a specialization in investing in foreign public debt) provided loans to countries in their own currencies, for purely military reasons, which sought to involve them in the alliance. As a result of the need to service these loans, the preconditions were formed for the accumulation of such a currency as a reserve. If we exclude the neglect of the factor of interstate movement of capital, in particular the external financing of public debt, which is mainly spent on military preparations, the "Mars hypothesis" before World War I becomes obvious.

In the analysis of statistical material B. Eichengreen, A. J. Mehl, L. Chitu came close to this factor. They rightly note the increase in the share of the French franc, especially in the reserves of Russia, while maintaining the stability of the share of the German mark. They also note the maximum role of the pound sterling at the beginning of the last decade of the 19th century. However, the authors state that it is impossible to determine whether this situation is the result of economic or political factors. In practice, as shown above, using the example of historical material, these factors are identifiable and economic in nature (since at that time government loans on concessional terms were almost not provided), but politically motivated. Thus, the authors provide data confirming the role of international capital movement in the formation of the status of a reserve currency, which in the period under review acquired the character of government loans in the lender's currency, due to which forced preparations for war were ensured within the framework of emerging military alliances.

Similarly, when considering the economic justification of the "Mercury hypothesis", the authors, although they do not ignore interstate borrowing and foreign investment, hardly link them with the real needs of military development. Directly speaking about the connection between military alliances and borrowing, the authors do not specify the purpose of such borrowing, and also separate interstate loans and private investments, which in practice are closely connected, especially in the pre-war period, when investors faced a real threat of at least freezing access to their property in a hostile state. In addition, the special investment attractiveness for private capital of investments in the military-industrial complex, supported by the state as a customer of products and as an investor, especially noticeable in the period preceding the world wars and the interval between them, is not considered. Meanwhile, if today the supply of weapons, especially to less economically developed countries, is often carried out at the expense of loans issued on the most favorable terms by the country — the manufacturer of weapons and military equipment, then in the period preceding the First World War, the situation looked different. Concessional lending could be called conditional, and the link between the loan and the purchase of specific types of weapons existed rather at the level of agreements than formal contracts. The classification of creditors as public and private is very confusing. For example, after the October Revolution and the refusal of the Bolsheviks to pay foreign debts, and then at the stage of restoring diplomatic relations with France and repaying some of them, it turned out that many French investors, sincerely considering themselves creditors of the imperial government, in practice acquired bonds of private issuers. Thus, when accounting for the movement of capital, attributing it exclusively to supporting the "Mercury hypothesis" for the period under review is the least justified and confusing in terms of the pre-war existence of the metal standard, the inflation caused by the war, and the complete rejection of the obligations assumed by the losing states (including Russia).

CORRELATION OF DIPLOMATIC MISSIONS WITH ALLIED RELATIONS AS A RATIONALE FOR THE CHOICE OF A RESERVE CURRENCY

Within the framework of the mathematical analysis of the "Mars hypothesis", the quantitative assessment of diplomatic representation as correlated with allied relations is extremely vulnerable. Such a concept is not true today, all the more it was incorrect at the turn of the 19th and 20th centuries when the level of diplomatic contacts in many respects still bore an echo of

the old dynastic relations. The level and scale of diplomatic representation were regulated by traditions, including those based on the feudal hierarchy. Representation at the court of the monarch could not be below a certain level under any circumstances (except for a complete break in relations) and, moreover, it had to be headed by a person whose status allowed him to be admitted to the court and received with respect not only because of his diplomatic rank but also because of the origin (even if the diplomat represented the republic). As a result, the mutual diplomatic representation of the leading European states, as today, was based on the "mirroring" principles.

Regarding both the registration and the maintenance of allied relations (the level of which is analyzed by the authors), these activities were mainly carried out by individual delegations, since the diplomatic missions did not have the appropriate authority or qualified personnel in sufficient numbers. As an example, it is enough to cite the visit to St. Petersburg of the Deputy Chief of the French General Staff, during which a draft military convention was signed by military representatives of the two countries. The permanent French diplomatic mission was engaged only in the technical support of these negotiations, and later — in the technical implementation of the agreements [4, p. 105]. It follows from this that the level of diplomatic representation as an indicator of the closeness of allied ties in relation to that historical one, although carefully analyzed by the authors, cannot influence the final conclusion on the problem under study.

GENERAL CONCLUSIONS OF EICHENGREEN, MEHL AND CHITU

The main conclusion of the authors is that the dominance of the US dollar as a world reserve currency is supported by the status of the issuing country as a superpower guaranteeing the security of the allied states. The issuance of such a currency, in turn, reduces the cost of financing the budget deficit. Further, the authors conclude that if the US policy is more isolationist, the attractiveness of their currency will also decrease, and funds to implement such a scenario will be invested in yen, euro, and renminbi. As a result, the long-term debt interest rates will increase by 80 points, which will be equivalent to an increase in annual interest rate payments (applied to 2016) by $ 115 billion. The US dollar will depreciate by 5%. The authors compare these losses with the costs of supporting the U.S.'s military presence overseas estimated at $ 10 billion per year, 70% of which is spent in Germany, Korea, and Japan (US Senate, 2013). The independent estimate is significantly higher at $ 100 billion per year (Vine 2015).

At the same time, the authors' concept suggests that the loss of security guarantees provided by the United States will increase the global military-political tension. In turn, the states will need to increase the share of more reliable currencies in their reserve holdings, by turning to the US dollars. As a result, on the one hand, getting rid of dollars due to the loss of American security guarantees and, on the other hand, acquiring dollars in an effort to have large reserve holdings, long-term interest rates on the US public debt still increase by 30 percentage points.

REALISTIC SCENARIOS OF THE LOSS OF THE RESERVE CURRENCY STATUS BY THE US DOLLAR DUE TO THE INABILITY TO GUARANTEE THE SECURITY OF ALLIES AND THE APPEARANCE OF NEW SECURITY GUARANTORS

The last statement does not quite fit into the framework of the concept proposed by the authors. First, it is highly unlikely that the US currency will remain attractive as the country moves to a policy of isolationism. Such a transition can occur either as a result of the loss of the ability to guarantee the security of the allies due to the decline in the country's military potential or as a result of a break with the allies due to the intensification of insurmountable contradictions. The first arises either as an outcome of military (diplomatic) defeat and changes in the global balance of power, or as a result of significant degradation of the national economy, which does not allow maintaining the military potential at the same level. In both cases, the attractiveness of the reserve currency of a country that has suffered such a heavy defeat or

plunged into the abyss of a large-scale economic crisis will sharply decrease. The second option is more realistic and presupposes the gradual development of economic contradictions to a level at which the costs of allied relations become unacceptable. However, even then, the willingness to abandon the US dollar as a reserve currency among countries disintegrated by trade wars will outpace the abandonment of the union itself, which, while remaining more formal and ineffective, may continue to exist for quite some time.

Moreover, this logic of choosing a reserve currency is obvious for countries that are not directly in allied relations with the United States. For them, the reasons for the US withdrawal from the position of the world military-political hegemon will either determine the decline in interest in their currency even before the fact of such a withdrawal is stated, or coincide with it in the course of a large-scale crisis caused by their military and diplomatic defeat.

The consequences of the US's refusal to provide security guarantees to its allies are important, but the authors ignore them. The resulting vacuum will be filled either by a system of regional alliances or, more likely over a longer period of time, by a new hegemon. Since we are talking about the choice of a reserve currency by each individual country (and not all countries can guarantee their own security), such guarantees after the US withdrawal will be obtained rather quickly — either in the form of a voluntary alliance or under pressure — the use or threat to use power to turn the country into a satellite. The question arises about the connection in this hypothetical situation of the possibility of providing military-political guarantees and the potential of the national currency of the guarantor country. It should also be considered that if currencies of states opposing each other are present in the composition of reserves, hypothetically, in approximately equal shares, the security guarantees of such states, if given simultaneously to one country, are in the nature of a temporary compromise, ending in the triumph of one of the opposing forces. We will consider the situation with potential guarantor countries in the case of a hypothetical withdrawal of the United States, analyzed by the authors.

China is undoubtedly capable of acting as a guarantor of security, although today the ability of the country, given the relative weakness of its navy, to project power beyond the Indo-Pacific region is seriously questioned. It will be all the more difficult for China to wage two major military conflicts overseas at the same time, which is a distinctive feature of the military-technical base of the current great power of the United States. The military potential of Japan is of purely regional importance and today is sufficient for the proper defense of the Japanese archipelago in the event of a non-nuclear conflict.

The military-technical potential of a united Europe is significant and in the long term may be equal to the potential of the United States. However, this is just the potential of an economic-political, not a military-political alliance. The military planning bodies of the EU are in their infancy, the military-industrial complex of the EU countries is integrated, but they retain their national specifics, their cooperation does not yet surpass similar interaction with the military-industrial complex of the United Kingdom (which has already left the union) and the United States. In general, we can only consider separate programs and a specific list of intentions to create a unified defense space. At the same time, due to the significant differences in foreign policies outside the European continent, there is no doubt about the ability and readiness of the integrated military component of the EU to guarantee the security of its members and a number of neighbors on a continent (possibly in the Mediterranean area) in some indefinite future. However, it is difficult to imagine that the willingness of the union would entail additional costs in building the capacity to project global power.

On the other hand, the authors did not mention the British pound sterling in the list of currencies that could challenge the US dollar, within the framework of their hypothetical scenario. This is all the more strange because the United Kingdom has nuclear weapons and a powerful balanced navy (according to various estimates — the second or third in the world), capable of operating in all

Table

Providing security guarantees in connection with the reserve currency

Countries	Ability to provide security guarantees	Assessment of a currency as a reserve currency	Role in the global financial infrastructure
China	High	Low	Absent
Japan	Absent	High	High
EU	Regional	Global	High
Russia	Global	Low	Absent
UK	Absent	High	Global
India	Regional	Low	Absent

Source: compiled by the authors.

corners of the globe. The absence of the Indian rupee on the list is also not entirely clear — from the point of view of problems with convertibility and freedom of movement of capital, it is slightly inferior to the Chinese yuan, as well as the military power of India in the regional aspect somewhat, but not radically inferior to the Chinese. Finally, it is not at all clear whether the list includes the Russian Federation, the economy of which is much inferior to that of China, Japan, or the common European, but the Armed Forces are comparable in the potential to the former and surpass the last and third. In terms of regulation, the Russian ruble is at least as good as the Chinese yuan. The *Table* shows the possibilities for providing security guarantees in relation to the reserve currency.

The research method is the analysis of historical material, as well as the current state of the issue under consideration.

As we can see, at the level of scenarios, the authors' concept is vulnerable — it is easy to assume a weakening of the United States and its transition to a policy of isolationism, accompanied by a reduction in military spending (which, by the way, will save significantly more than the aforementioned $ 750 billion). Likewise, it is easy to allow the US dollar to lose its position in favor of the currencies of other powerful economies. However, this series does not in any way integrate military security guarantees that support the claims of the currencies of such states for the status of reserve ones. Based on this, it seems logical to assume that the military dominance of the United States is predetermined by the same economic considerations as the dominance of its national currency.

Indeed, the history of the United States confirms this thesis. Considering the fact that the United States, before the Nazi occupation of France in 1940, did not even give secret and vague security guarantees to any European country, and in Asia, these guarantees extended only to formally independent states (primarily the Philippines), where the American military contingents were deployed, the "Mars hypothesis" in the interpretation proposed by the authors remains unconvincing. In a logical chain, they quote: military power; security guarantees; the presence of a reserve currency — in relation to the situation in the United States in the period from 1875 to 1940, the first component is not exhaustive and does not allow providing the second (which, in fact, is absent), and the third is not only happening but is also consistently strengthening.

A vivid example is the USSR, which obviously possessed both global military power and the largest (along with the United States) nuclear missile potential, which allowed it to provide comprehensive security guarantees in any corner of the globe. However, none of these prerequisites in any way predetermined even a limited interest in the Soviet currency.

THE INEVITABLE COMBINATION OF MILITARY HEGEMONY AND THE OWNERSHIP OF RESERVE CURRENCY

As a result, we come to the conclusion that a large modern economy producing a wide range of

products, including high-tech and integrated into world trade, will inevitably have either available military power or the potential to create it in a short time, as well as a reserve currency that has already become global or able to become it. The question, therefore, boils down to one thing: is it inevitable, upon the achievement of military superiority, which makes it possible to become a hegemon within the framework of a military alliance, the acquisition of the status of a reserve currency by the national currency?

After World War II, as the authors rightly point out, security was guaranteed by the presence of nuclear weapons. However, of the two powers that originally possessed it, only one — the United States — issued the world reserve currency. Great Britain had a reserve currency before gaining access to nuclear weapons, the popularity of the French franc since the 1960s inferior to the popularity of the West German brand, despite the *presence* of nuclear weapons in France and their *absence* in Germany. The China currency aroused interest in the world *half a century* later after the country received nuclear status. The unofficial members of the "nuclear club" obviously do not apply for the status of the owner of the reserve currency.

At the same time, it is difficult to deny the fact that military power and security considerations cannot but serve as a weighty argument both in economic disputes and in economic cooperation.

The authors' general conclusion that the loss of the United States' role as a global leader, guaranteeing the security of numerous allies, will lead to higher American interest rates, is not in doubt, but the question remains open about the reasons for such changes. Since, as shown above, such a loss may be the result of either large-scale military-diplomatic defeats, or a sharp exacerbation of the situation in the national economy, and it is very likely both at the same time, the authors' assessment seems excessively optimistic. On the other hand, there is no reason to believe that with the preservation of the economic and military status quo or its slow natural transformation, the United States will radically change its global status. Thus, it is impossible to determine the choice between the "Mars hypotheses" and "Mercury hypotheses" simply because military power is based on economic power, and its configuration is largely determined by considerations of ensuring economic activity.

ATHENA HYPOTHESIS

And here we return to the problem identified by the authors when considering the state of foreign exchange reserves prior to World War I. It seems reasonable to ask the question: if the connection between military leadership and the role of the currency as a reserve currency is refuted by a number of notable exceptions, which casts doubt on the "Mars hypothesis" and, at the same time, the military-political factor is present in the context of economic leadership, which does not allow taking the side of the "Mercury hypothesis", why not consider the issues of trade in relation to the military component, that is, trade (including the cross-border movement of capital), which provides military construction? This hypothesis could be called the "Armed Mercury hypothesis", but the name "Athena hypothesis"[6] looks more attractive.

The essence of this hypothesis is that military power is based on economic potential, and if the former is superior to the latter, then it is neither sustainable nor long-term, nor provides economic preferences in international trade. Military power does not create any additional investment attractiveness, including the attractiveness of the national currency, as well as a reserve one. The exception established by the authors for nuclear missile power is seeming since in practice this is confirmed only by the example of the Russian Federation, for which the corresponding potential significantly exceeds the economic one. However, in this case, this does not cause any incentives to obtain security guarantees from its owner in connection with a number of economic

[6] Pallas Athena (among the Romans — Minerva) — the ancient Greek goddess of wisdom, the patron of states both in days of peace and during the war. This is the goddess of a just and reasonable war, in contrast to Ares (Mars), who patronized a cruel and bloody war. In addition, this goddess bestowed laws on people, patronized sciences, agriculture, and crafts.

concessions, as well as to obtain the status of a reserve currency for the national currency.

A direct link between military and economic potential arises mainly to ensure stable international trade, and, based on this, its naval component is of particular importance. Military power by itself, with the exception of cases of obvious inequality in the general potential of neighboring states, is not capable of providing its holder with significant economic preferences, including foreign exchange.

At the same time, the global capital market, which forms a complex system of interconnections and interdependencies in various spheres of interaction between states, plays a significant role in military-political alliances and the status of a currency as a reserve one. Since the pre-World War I period, this interaction has spread from providing loans to the state, which is planned to be involved in a military-political alliance, to providing such a state with the widest possible access to its own government borrowing instruments. The preferences in this process of attracting and distributing funds are indeed broadly, but not exclusively, predetermined by the military potential of the state. This potential, in turn, is supported by operations in the global money market, restricting access to which through sanctions is becoming an increasingly important form of interstate confrontation and a way to maintain global leadership.

Thus, neither the presence of military power nor the ability to provide partners with security guarantees predetermines the acquisition of the reserve currency status by a national currency. This status is being acquired as a result of control over global investment processes in their broadest sense, in the implementation of which military power plays a significant role. However, this power itself, as the potential for economic and financial domination, is a derivative of the scale and level of development of the national economy with a key factor of its deep involvement in international trade, which, in turn, generates an objective demand for long and stable existence of such power.

This implies the controversy of the theses about the a priori advantage for the emerging centers of power in the form of China and the EU of the interconnected spread of their military-political influence and the role of national currencies since both of these goals exist independently and in each case are determined by separate considerations. This, in fact, is confirmed by the absence of a direct correlation between the rather sharp strengthening (starting from the middle of the second decade of the 21st century) of the military potential of China with the role of the Chinese yuan in international settlements. At the same time, the reduction in the military potential of the EU during the first two decades of the 21st century was accompanied by the emergence of the euro, not without success claiming the role of a reserve currency.

CONCLUSIONS

It seems logical to conclude that in the foreseeable future, despite the strengthening of its military potential, China will not be able and, most likely, will not try to significantly raise the status of the yuan to the level of a reserve currency, implying accompanying costs in the form of the need for liberalization of financial system inadequate benefits. The United States, in turn, will increasingly use its dominance in the capital market and control over the global financial infrastructure as a tool to maintain global leadership.

Presumably, the noted relationships and interdependencies still exist separately. Thus, the military power of a state is considered when assessing the attractiveness of its currency, although, as the experience of modern Russia shows, it is by no means decisive. Political-military alliances affect the attractiveness of the currencies of their members as a reserve, but this influence becomes direct, mainly based on considerations of military-technical cooperation, which is a separate and very specific area of economic activity. Military power is only partially formed from considerations of interstate economic cooperation, while for the latter, not a nuclear missile, but naval power still has a special and almost exclusive significance (at the moment they are basically the same, but not identical).

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