

# *The US Dollar and the World Economy*

Since the United States went off the *gold standard* in 1971, the US dollar has relied on the *full faith and credit* of the country's economy to keep its value as a currency both here and abroad. Prior to 1971, the US dollar was pegged to the gold standard where the US government promised to pay or to exchange a certain amount of gold for every US dollar it received. This was sort of an IOU to exchange gold for US dollars. Gold is a valuable commodity with many uses, including in jewelry, metal alloys, electronic circuit boards, and other manufacturing applications. Since there is a limited amount of gold available in the world markets at any one time, the demand for gold remains consistently high and its price remained relatively stable for many years. It was therefore relatively easy to use gold as the standard in which to value one nation's currency against another nation's currency.

When the United States went off the gold standard in 1971 the US dollar then became backed by the *full faith and credit* of the US government. The United States government promised that people and countries could exchange US dollars for an equal value of goods and services that were produced by the US economy. The intrinsic value of the US dollar was based on the inherent strength of the country's economy. The dollar's value depended on whether or not people around the world believed the US economy would continue to grow at a healthy pace and how the US economy was doing compared to the economies of other nations. The best analogy is that the US dollar became a sort of commodity or stock.

Even after the United States went off the gold standard, foreign governments and people around the world continued to accept US dollars as payment for their goods and services. They decided not to immediately exchange the dollars for US goods and services, and instead decided to hold onto them. The dollars held offshore became IOU with the promise

that America will pay these debts at some point in the future. One of the major reasons they decided to hold onto their hoard of US dollars was because they felt the American economy was continuing to grow at a healthy rate. They believed that the US dollar was more valuable in the long run than their own currency or the value of goods and services they could receive now in the exchange. One of the benefits was that foreign goods became cheaper because the United States economy did not have to repay this IOU right away. This was all right when the US economy remained strong, but becomes a problem with the economy weakens. A weaker dollar means Americans have to pay more to buy the same amount of goods and services from abroad. It also means that all those IOUs that America has been building up all these years are coming due as the offshore US dollar holdings will be returning to the United States. Foreign governments and people will be using their dollars to buy goods and services in the United States, in direct competition with US residents, thereby driving up the price for local inhabitants.

It has the same effect as when the bank and credit card companies call in their loans, and at the same time jack up their interest charges. The effects can be quite stressful.

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