Fundamentals vs. Policies:
Can The US Dollar's Dominance In Global Trade Be Dented?

Discussion of Georgiadis, Le Mezo, Mehl and Tille (2021)

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The views expressed here do not necessarily reflect the position of the Bank of England.

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An important question:

- DCP has implications for cross-border spillovers and optimal policy, so illuminating to understand its underpinnings
  ...why is USD dominant?
- Currency dominance changes slowly and not at polar extremes
  ...what are the prospects of USD losing its dominance, and will RMB policies accelerate structural change?

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- New dataset on RMB invoicing shares
- Stylistic preference to restructure: (i) USD/EUR analysis, full dataset; (ii) RMB analysis

Empirical Specification and Key Results

Simplified specification for x and m shares with key results:

$$InvoiceShare_{i,t}^{\ell} = \alpha_i^{\ell} + \tau_t^{\ell}$$

where $\ell \in \{\$, €, \text{RMB}\}$

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Three comments:

- #1 Measuring strategic complementarities and potential non-linearities
- #2 Measuring GVC integration
- #3 Other determinants of currency invoicing?

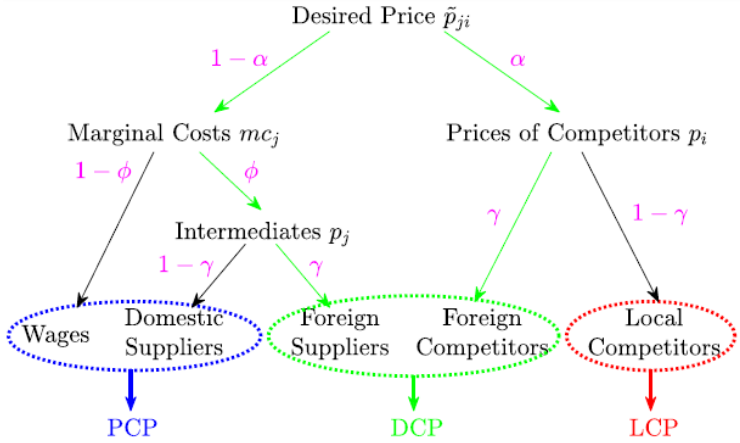
#1: Strategic Complementarities and Potential Non-Linearities

- $StratCompl_{i,t}$: country i's exposure to strategic complementarities in price setting from sectoral composition of exports (more homogeneous $\Rightarrow$ more compl.)

- **Is the relationship between $InvoiceShare^{\ell}_{i,t}$ and $StratComp_{i,t}$ necessarily linear?**

Theory Suggests Potential Non-Linearities

Figure: Stylised Representation of Model in Mukhin (2022)



α degree price complementarities; ϕ intermediate input share; γ domestic exp. share

#1: Strategic Complementarities and Potential Non-Linearities

- $StratCompl_{i,t}$: country i's exposure to strategic complementarities in price setting from sectoral composition of exports (more homogeneous $\Rightarrow$ more compl.)

- **Is the relationship between $InvoiceShare^{\ell}_{i,t}$ and $StratComp^{\ell}_{i,t}$ necessarily linear?**
  Theory suggests it might not be!

- **Practical suggestion**:
  1. Distinguish strategic complementarities in price setting from sectoral composition of exports (i) to US(/EA) (where LCP≡DCP) $StratComp^{US}_{i,t}$ and (ii) to non-US(/EA) $StratComp^{nUS}_{i,t}$
  2. Include both in regression, with squared terms and hypotheses that:
     - $StratComp^{US}_{i,t}$ has linear relationship with $InvoiceShare^{\ell}_{i,t}$
     - $StratComp^{nUS}_{i,t}$ has concave quadratic relationship with $InvoiceShare^{\ell}_{i,t}$

#2: Measuring GVC Integration

- $GVCInt_{i,t}$: country i's backward GVC integration ('vertical specialisation'), i.e. imported input content of exports
- But many measures of GVC integration exist [see Baldwin and Freeman, 2022 for recent survey]

▶ **Is this the 'right' (or, at least, best) measure of GVC integration to use?**

Theory Suggests the Exact Measure May Not Be (That) Important

Within a standard open-economy macro model, various (steady-state) measures of GVC integration are function of imported intermediate share m and labour share LS. E.g.:

- **VAX Ratio**: Share of domestic value-added in gross exports [Johnson and Noguera, 2012]

$$VAX = \frac{LS}{1-(1-LS)(1-m)+(1-LS^*)m^*}$$

[Georgiadis, Gräb and Khalil, 2019]

- **Backward GVC Linkages**: Imported input content of exports [Hummels, Ishii and Yi, 2001]

$$BL = \frac{LS^*(1-m)(1-LS)}{[1-m(1-LS)][1-m^*(1-LS^*)]-(1-m^*)(1-m)(1-LS^*)(1-LS)}$$

[D'Aguanno, Dogan, Lloyd and Sajedi, forthcoming]

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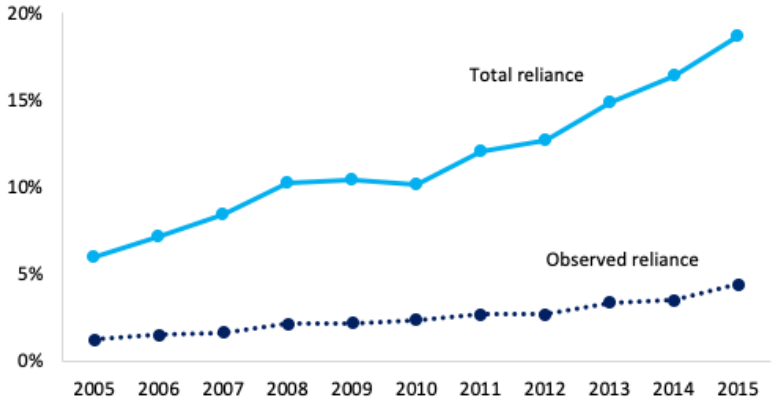
  Theory suggests it might well be!
- Nevertheless, empirical estimates can differ substantially

An Example

Observed and Total Reliance of US Motor Vehicle Sector on Chinese Inputs

Figure: Alternative Measures of GVC Integration from Baldwin and Freeman (2022)



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- **Practical suggestion**:
  #1 Draw on theory more explicitly to support variable definition
  #2 Explore alternative empirical measures of GVC integration to *either* lend support to theory, *or* highlight challenges

#3: Other Determinants of Currency Invoicing

- Paper focuses on trade-based determinants of currency invoicing (as well as PBoC policy)
- But other factors likely to play a role

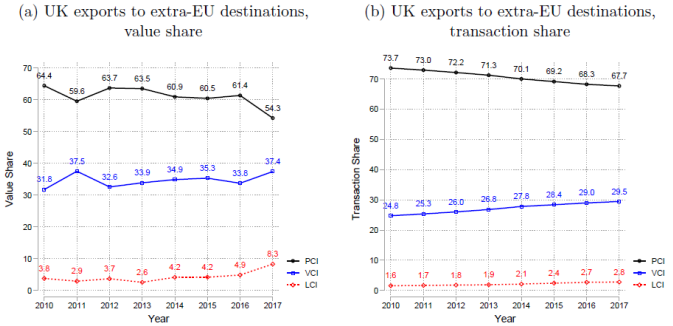
▶ **What about the role for financial development, and financial integration?**

UK, and the GBP, is an Interesting Example

- UK is leading international financial centre
- PCP is prevalent in UK exports, with firms often invoicing in more than one currency

[Corsetti, Crowley and Han, 2022]

Figure: Aggregate Composition of Invoicing Schemes in Corsetti et al. (2022)



#3: Other Determinants of Currency Invoicing?

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- **What about the role for financial development, and financial integration?**
- **What about commodities?** Are these factors really accounted for by fixed effects?
  - Several commodity exporters are price takers on global markets [Tenreyro, 2019]

  ⇒ Strategic complementarities and backward GVC integration unlikely to govern currency choice

  ⇒ With wages sticky in domestic prices, constraints for exporters on supply side

  [Drechsel, McLeay and Tenreyro, 2019]

To Sum Up

- ⋆ Welcome and timely empirical analysis of determinants of currency invoicing, spanning broad set of countries
- ⋆ Novel early analysis of RMB invoicing, and role of PBoC policies

- · Should we expect the relationships to be linear?
- · Can the link to theory be made more explicit (in places)?
- · What else matters for currency invoicing?

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