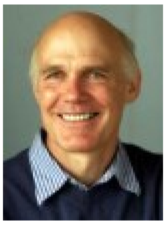
Long Read: The beginning of the end for the US dollar’s global dominance.

*The US dollar has been the global reserve currency for over 70 years, enhancing American financial and economic power.* **Robert Wade** *writes that the weaponization of the dollar and the dollar payments system against countries such as Russia and Iran over the past decade has incentivised others to find ways to escape the dominance of the US dollar. He looks at just how central the US dollar is to the global economy, and how countries such as the BRICS have been working to create their own alternatives such as new international currencies and using other currencies in important commodity trades such as oil. De-dollarization is coming, but anything close to the end of dollar dominance will be decades ahead.*

The air rebounds with claims of “the end of dollar hegemony”, “the end of American financial supremacy”. Some of this has been prompted by unease and even outrage at the US government’s overt “weaponization” of the dollar and the dollar payments system in the past few years, to sanction enemies like Iran, Cuba, Venezuela, Afghanistan, North Korea, and China. The US took weaponization to a new level when it used the dollar payments system to freeze Russia’ s access to $300 billion in liquid foreign exchange reserves in the wake of Russia’ s invasion of Ukraine in February 2022. Now influential voices are urging the US government to go further and *appropriate* those reserves (take ownership of them, not just freeze them), and give them to the government of Ukraine for post-war reconstruction. Those who think their states might be subject to the same punishment have started to search anxiously for ways to escape dollar dominance.

Escaping dollar dominance

Confidence is an indispensable requirement for a currency, and beyond a certain point of weaponization the US undermines international confidence in the dollar as the world currency and accelerates states' search for alternatives. The more talk there is of appropriating Russia's reserves the more countries like China fear their reserves held in dollars or euros may no longer be safe.

So now the BRICS (Brazil, Russia, India, China, and South Africa), led by Russia, are discussing how to escape dollar dominance. Russian President, Vladimir Putin forecast the "beginning of the end" for the dollar in June 2023. Former president of Brazil, Dilma Rousseff, current chair of the New Development Bank, has pledged to "find ways to avoid … being dependent on a single currency". The Brazilian finance minister has previously called for a South American international currency, beginning with Brazil and Argentina.

"Untitled Project: Dollar [Sign]" (CC BY-NC-ND 2.0) by untitledprojects

Even the European Union has recently shown signs of wanting to escape dollar dominance. The German foreign minister has called for a new EU-based payments system independent of the US and the SWIFT payments system, that would not involve dollar payments.

But people have been forecasting the end of dollar hegemony for half a century and more, for reasons to do with the inherent difficulties for the US central bank to balance supplying enough dollars for global transactions and few enough dollars to sustain confidence in the value of the dollar. This issue led economist Robert Triffin in 1960 to warn of an “imminent threat to the once-mighty US dollar” (his argument came to be known as “the Triffin Dilemma”). Economic historian Charles Kindleberger declared in 1976 that “the dollar is finished as international money”. When French president Nicolas Sarkozy chaired the G20 in 2010 he took the opportunity to decry the model that left “part of the world dependent on US monetary policy”.

Dollar hegemony will surely end – but not in the foreseeable future. Most of the world has no prospect of an alternative to the international dollar to be used at scale in the next two decades or so.

Quantitative dominance of the international dollar and dollar payments system

The dollar and dollar payment system remain overwhelmingly dominant. According to the Bank for International Settlements’ latest triennial survey, the dollar as of 2022 was part of 88 percent of all international transactions. That percentage is only slightly lower than in 1989, testimony to the dollar’s resilience. Meanwhile, the euro accounts for 31 percent of international transactions, the yen 17 percent, the pound 13 percent, the renminbi (RMB) only 7 percent, up from 4 percent in 2019.

As a share of global foreign exchange reserves, the dollar now accounts for around 60 percent, down from 72 percent in 2000. Over this period the RMB share grew from zero to 2.6 percent.

Incumbency advantages

Dollar dominance rests on huge incumbency advantages — institutions which give the dollar system huge economies of scale and network externalities, such that the more users the more people need to use it. The institutions include Wall Street and US Big Tech (Google, Facebook, Apple, Amazon, Uber), which dominate the world system, and they have no incentives to de-dollarize. The US has well protected property rights; a court system and central bank vested with high confidence around the world; the world's deepest, most liquid, most open financial markets, which function in dollars; and effective macroeconomic management most of the time, producing low inflation.

Dollar dominance allows the US to sustain large current account deficits – importing much more than it earns from exports, thereby "artificially" boost living standards for a large subset of Americans. Also, it lowers US corporations' cost of foreign direct investment (FDI), fuelling their expansion around the world. And it allows the US to easily finance its military activities around the world.

Established half a century ago, SWIFT (Society for Worldwide Interbank Financial Telecommunication), is the crucial nerve center of the global financial network, the message system through which all major banks transfer all major currencies. It carries over five billion financial messages a year. It is beyond US direct control, and does not actually move money; it simply tells one bank to debit an account and credit another. A Shanghai bank wanting to send funds to a Sydney bank must go through SWIFT.

Kicking a country off SWIFT constitutes a severe national blow. In 2012 the US – the European Union went along – kicked Iran off SWIFT, which meant it could not receive hard currencies for its oil exports. The blow was severe enough, coupled with a change in government plus a change in US policy on nuclear enrichment, for Iran to come to the bargaining table in 2015 and agree with the US to restrain its nuclear program. The US kicked Russia off SWIFT after its early 2022 invasion of Ukraine; or to be more exact, kicked 10 of the largest Russian financial institutions off SWIFT.

Over the past decade the US government has increasingly used its control over the dollar – whether directly or indirectly via SWIFT – to sanction countries and private entities and individuals that it deems hostile. Putin lamented in 2018, "We aren't aiming to ditch the dollar. The dollar is ditching us."

Most banks globally have no choice but to comply with US sanctions, because they cannot afford to let go of correspondent banking relationships with US banks. If banks' transactions with US enemies are in dollars they will pass through a US-based clearing house, making them subject to US laws.

We should also not omit the dollar system's geopolitical underpinnings. The US has some 700 overseas military bases spread over 80 countries, and a military budget greater than the military budgets of the next 10 countries combined. This is especially relevant to the case of Middle East oil and its pricing in dollars. China does not (yet) have the military capacity to persuade US allies in the Gulf to switch sides.

Limits on bilateral trade agreements in national currencies

Agreements to use national currencies in bilateral trade agreements are increasing and could speed up de-dollarization. But so far, they remain mostly at cosmetic scale. They are inherently limited by the fact that there are surplus and deficit countries in these exchanges. Surplus countries accumulate monetary assets in the currencies of the deficit countries and may be wary of doing so because of the risk of inconvertibility and depreciation. Deficit countries may worry that surplus countries will dump their currencies in international currency markets in the search for safer assets.

Russian-Indian trade negotiations reached stalemate in May 2023 over the issue of conducting commerce in Indian rupees. India wanted the transactions to be in rupees, but because the trade balance favors Russia, Moscow feared drowning in unusable rupees. They reached a compromise with India paying for Russian oil with Emirati dirhams.

Photo* by *Eric Prouzet* on *Unsplash

Saudi Arabia seems to be issuing threats to make oil contracts in non-dollar currencies as part of a multipronged bargaining strategy with the US. When the Saudi finance minister announced in January 2023 (at the Davos World Economic Forum meeting) that his country was open to using currencies other than the dollar in oil contracts, he could not have expected the intense media attention. His remark ran against the decades-long implicit agreement that the US would supply Saudi Arabia with military support and OPEC would use the US dollar in its oil sales.

In 2021 Saudi Arabia signed a military cooperation agreement with Russia, implying the US was no longer the sole protector of the kingdom. The Saudi finance minister's 2023 announcement at Davos went with Saudi normalization negotiations with Iran under Chinese mediation and the resumption of normal diplomatic relations between the two countries. Also, with expanding bilateral ties between Saudi Arabia and China. And with close cooperation with Russia in OPEC since Russia's invasion of Ukraine in early 2022, to prop up oil prices.

In response the US began to be more positive towards Saudi Arabia, which was probably the Saudis' objective; to see what the US offers it *not* to price its oil sales in currencies other than the US dollar.

Proposed BRICS currency

Russia has taken the lead in promoting the idea of a BRICS international currency, initially as a *unit of account* in transactions between the BRICS, so that the prices in these transactions would not fluctuate with the dollar. The intention is to get the unit of account up and running before taking steps to add the two other essential functions of a currency, a *store of wealth* and a *medium of exchange*.

The plan for a BRICS currency was quietly discussed at the BRICS summit in August 2023, under the name of the R5 (the currencies of all five BRICS begin with "r"). But there is strong resistance within the coalition (think of the tensions between China and India). The Leaders' Declaration endorsed the general merit of de-dollarization – it encouraged the use of national currencies in trade and finance between the BRICS — but made no mention of a common currency. Perhaps the BRICS Summit in 2025 in

Brazil will announce concrete steps to the creation of a limited BRICS currency since the Lula government is enthusiastic about the idea.

The RMB?

What are the prospects of the RMB becoming a significant international currency? It is widely assumed that the US reaps an “exorbitant privilege” from having its currency also function as the international currency. But some analysts, including Michael Pettis, argue that *the dollar is now an “exorbitant burden” to the US.* The US must issue floods of US dollar assets to provide the world with the liquidity it needs, and other countries’ demand for these safe assets tend to fuel speculative bubbles in the US, such as mortgage-backed securities, notably the sub-prime mortgage securities in the run-up to the Great Crash of 2008.

To the extent that Beijing realizes that a national currency which functions as an international one can impart an exorbitant burden as well as exorbitant privilege, it may hesitate to promote the RMB. As leader of the Global South, it may still *criticise* dollar hegemony, while *acting* to support dollar hegemony for the most part, promoting RMB internationalization only at the margins. It is striking that China is following US-led sanctions against Russia. The Asian Infrastructure Investment Bank (AIIB), led by China, has *cut off Russia’s dollar financing.*

Significant internationalization of the RMB would depend on a far-reaching re-set of US-China relations. For US firms to buy up large quantities of RMB securities they would have to judge the risk of US sanctions on China – such as US freezing of China’s liquid reserves, never mind appropriating those reserves as voices are calling for with Russia – as being very low. Those risks would not be low if and when China invades or blockades Taiwan, as President Xi has many times declared China must be prepared to do.

Also, China’s RMB could be used on a significant scale as an international currency only if China opened its capital account and established deep capital markets beyond state control. Beijing has good domestic political as well as economic reasons for not doing so anytime soon. It is striking that *most of China’s lending for Belt and Road Initiative projects throughout the global South (around $1 trillion since 2013) is in dollars, to be repaid in dollars*.

Meanwhile, China's Big Tech firms (Alibaba, Tencent) are developing private sector retail digital payments, and as of 2023 they are preparing the system for wholesale and cross-border payments. But the central bank digital currency has had trouble breaking into the market.

A slow but steady move away from US dollar hegemony?

It is worth remembering two points. First, creating a widely used international currency is bound to take decades. It took four to five decades from when the US surpassed Britain as a global economic power in the late nineteenth century to when it became the dominant financial power and the dollar the dominant international currency. European efforts to create its within-Europe international currency began in 1972 with the small "snake-in-the-tunnel" agreement to limit fluctuations between currencies; and culminated in 1999, 27 years later, with a common currency. Beijing may be thinking of a similar "slow but steady" internationalisation of the RMB, crossing the river one stone at a time.

Second, major developing countries have started to create coalitions from which the US is notably excluded or has excluded itself: such as the Asian Infrastructure Investment Bank, the New Development Bank, the Shanghai Cooperation Organisation, and of course China's globe-spanning network of infrastructure alliances, the Belt and Road Initiative (BRI). In another few decades we may look back on this period as the early stage of a new geopolitical and economic environment in which the US is more marginal than it has been for more than eight decades, including its currency.

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