

THE DE-DOLLARIZATION PROCESS OF THE WORLD ECONOMY: CURRENT TRENDS, OBSTACLES AND FUTURE PROSPECTS

Joachim Marcos (Switzerland)

“Kept Tax and Advisory” LLC (former KPMG)

Abstract

This article discusses one of the key long-term geopolitical trends of the 21st century: the de-dollarization process of the world economy. The US dollar has been the dominant global currency since the end of the Second World War, granting the USA significant geopolitical advantages over other countries. However, the rise of new centers of power in the past decades, such as China, India, and Brazil, alongside the expansion of influential organizations like BRICS+, is significantly changing the realities of the world economy. These new centers of power are increasingly dissatisfied with the dollar's dominant position and are actively seeking to challenge its hegemony through various means. This article reviews the historical origins of dollar hegemony and explains how it poses a problem for many nations. Then, it aims to analyze the extent of the ongoing process of de-dollarization, its manifestations, and future prospects for the decades to come.

Keywords

Dollar hegemony, de-dollarization, Bretton Woods system, BRICS currency, petrodollars, multipolar, emerging countries, BRICS+.

INTRODUCTION

UNDERSTANDING DOLLAR HEGEMONY

The US dollar has a dominant position in the global financial system and could be considered a hegemon amongst currencies. It is the primary reserve currency, unit of account, and medium of exchange in international trade and financial transactions. According to the Bank for International Settlements, despite the United States accounting for just over a 10th of global trade, approximately half of global trade is invoiced in USD [1]. In addition, the USD comprises about 60% of the world's foreign reserve currencies [2]. The US dollar is unavoidable for both international companies and countries. This hegemony gives the USA significant economic and geopolitical advantages, including the ability to influence global markets and economies. The considerable leverage offered by the dollar is a powerful tool that can be used to pressure other countries and force them to conform to the will of the USA. The powerful position of the USA in geopolitics cannot be fully understood without properly recognizing the role played by the US dollar.

HISTORICAL BACKGROUND: THE RISE OF DOLLAR DOMINANCE

After the devastation caused by World War II, the world needed to be reorganised with a new international economic system that would facilitate growth and stabilize the global economy. The Bretton Woods Conference, held in 1944, aimed to address key issues concerning international trade, currency exchange rates, and general financial stability. It also led to the creation of institutions like the International Monetary Fund (IMF) and the World Bank, which provided mechanisms for financial assistance and stability among nations. An international unit of account had to be established to facilitate international trade and exchanges. At this conference, the choice was between an international unit of account (the "bancor", favoured by John Maynard Keynes and Britain) and the US dollar. The US dollar won the debate, under one particular condition to reassure other countries: the US dollar had to be "as good as gold", meaning that it would be strictly backed to the value of gold. Trading with dollars would then be equivalent to trading with gold, with dollars representing the physical pieces of gold.

The gold convertibility of the dollar was originally established at the exchange rate of 35 US dollars per ounce of gold. This successful arrangement paved the way for the dollar to become the dominant currency in foreign exchange reserves and international trade across the capitalist world. The stability of the Bretton Woods monetary order in the 1950s and 1960s was guaranteed by America's sizable gold reserves, current account surpluses, and unparalleled competitiveness in the world economy. The dollar hegemony was not only a reflection of American prowess, but also a means through which the US provided leadership to the capitalist world, promoting a stable environment for growth.

However, this status quo did not remain unchanged. By the late 1960s, the rising productivity of Japan and Europe, particularly West Germany, had eroded the US's competitive edge in the global economy. The diminishing competitiveness, increasing trade deficit, and escalating fiscal deficit - exacerbated by the US's troubled involvement in Vietnam - put the dollar's value under great stress. The American government was increasing the money supply of US dollars to cope with these massive expenses. As a result, countries around the world began to worry that the USA did not have sufficient gold reserves to support the growing amount of available dollars and started asking to convert

more and more of their dollars into gold. Ultimately, it left President Richard Nixon with few choices other than to officially suspend the gold convertibility of the dollar and reduce the current account deficit by devaluing the dollar in 1971. At this time, it could have marked the end of dollar hegemony. Indeed, the collapse of the Bretton Woods system in 1971 led many to predict the end of dollar hegemony and the rise of a multipolar global economic order based on the shared domination of a variety of currencies, including the yen and the deutsche mark. However, this multipolar moment never came, and the dollar has remained dominant since.

Instead of gold, the USA managed to back their currency with two other highly demanded products: military defence and oil. During the Cold War, the US provided military protection to its allies worldwide, including not only core capitalist countries in Europe and Japan but also key oil producers and other allied developing countries. The governments of countries under American protection, such as West Germany, were sometimes asked to support the dollar by increasing their purchase of US assets and military supplies, paid in dollars, under the explicit threat of a reduction of US troops stationed in their countries. In addition, countries looking to buy American military equipment had to do so in dollars. As a result, it became necessary for any country seeking American military support to hold considerable amount of dollars.

The second reason why dollar hegemony was maintained is that the main oil producers in the world began selling their oil exclusively in dollars. In 1974, the USA and the House of Saud of Saudi Arabia reached an agreement, establishing to conduct their oil sales exclusively in US dollars. In addition, the dollars received by the Saudis (called “petrodollars”) would be recycled through US financial markets to buy US Treasury bills in support of the American economy. In exchange, the Saudis were rewarded with prime coverage under the US security umbrella and sales of military weapons. These terms were extended to encompass other main members of the Organization of Petroleum Exporting Countries (OPEC) in 1975. Since all countries worldwide need oil to function, the US dollar became indispensable and unavoidable. This agreement has been strictly complied with by the Saudis and the Gulf states that are members of OPEC since then, reinforcing the US dollar’s position for the past four decades.

Finally, the financialization of the global economy, led predominantly by the United States with major financial hubs such as New York and Chicago, established the US dollar hegemony for good during the 1980s and 1990s. America’s financial institutions were leaders in the innovation of numerous financial products, such as derivatives, bonds, and other securities that are traded and valued in US dollars, thereby extending the currency’s reach and influence across global markets. The liquidity of the US dollar, coupled with the United States’ openness to global financial flows, has positioned both the country and its currency as leaders in the financialization of the world economy. The US dollar’s unrivaled liquidity means it can be easily bought, sold, or used in transactions anywhere in the world, attracting significant foreign investments.

As a result, despite the end of the gold standard, the dollar remained the world’s dominant currency. Additionally, there is a snowball effect to consider. Once the dollar’s status was well-established, it became difficult for any player to decline its use. Everyone became accustomed to conducting business and accounting in dollars, making its use even more unavoidable.

CONSEQUENCES OF DOLLAR HEGEMONY: WHY NATIONS SEEK ALTERNATIVES

This situation grants significant advantages to the USA. First, it enables them to unilaterally sanction any country or company of the world by cutting

them off the dollar. It also threatens to sanction any actor that does not respect American sanctions. Thus, many countries, like Venezuela, Cuba, or Iran have been under economic sanctions imposed by the USA, bypassing the regular sanction procedure of the UNSC. Latin American countries have expressed their opposition to unilateral sanctions on Cuba or Venezuela multiple times, but their requests have been ignored [3]. An increasing number of countries are dissatisfied with this American ability to impose its will on other regions and nations.

Secondly, all companies of the world operating in dollars have to respect US sanctions, treaties, or commercial laws, even if none of them is American or operating within the USA. This principle is known as the extraterritoriality of US law. As a result, all companies operating in dollars are under the threat of being cut off from American dollar if they do not adhere to their requirements.

Thirdly, as the demand for USD in the world is close to unlimited, it grants the USA the privilege of financing itself in a massive way with very few repercussions. Even if the USA is already in considerable debt, actors will continue to buy its treasury bonds because they always need dollars. This allows the USA to cover substantial negative trade imbalances (more than 800 billion USD in trade deficit in 2021 and 2022) [4] and fund costly military operations in Iraq or Afghanistan, which have amounted to trillions of dollars. In contrast, if any other country faced expenses of a similar magnitude, its currency would experience great devaluation and inflation, potentially leading to national bankruptcy. In addition, the extensive holdings of dollars by countries and companies worldwide render them vulnerable to potential devaluation. Any significant depreciation of the US dollar would have widespread implications, as it would erode the value of everyone's holdings around the world. Provocatively, this phenomenon could be called "We get into debt, you pay". Therefore, whenever the USA decides to spend large amounts of dollars - whether for its operations in Afghanistan or, today, in support of the Ukrainian government - the costs are shared among the whole world when it acquires new treasury bonds issued by the USA.

NEW INCENTIVES FOR DE-DOLLARIZATION POST COLD WAR

Since the end of the Cold War, the economic realities of the world have changed considerably. Countries previously described as "developing" or "emerging", such as India, Russia, Brazil, and China, have significantly developed over the past thirty years and now represent larger shares of the world economy. On the other hand, Western economies have seen their share reduced and no longer represent the main drivers of world economic growth. These changes are visible on the graphs below, which represent the share of countries in the world's GDP (per PPP) over time, according to the IMF. The scale is logarithmic for better visualization of this evolution.

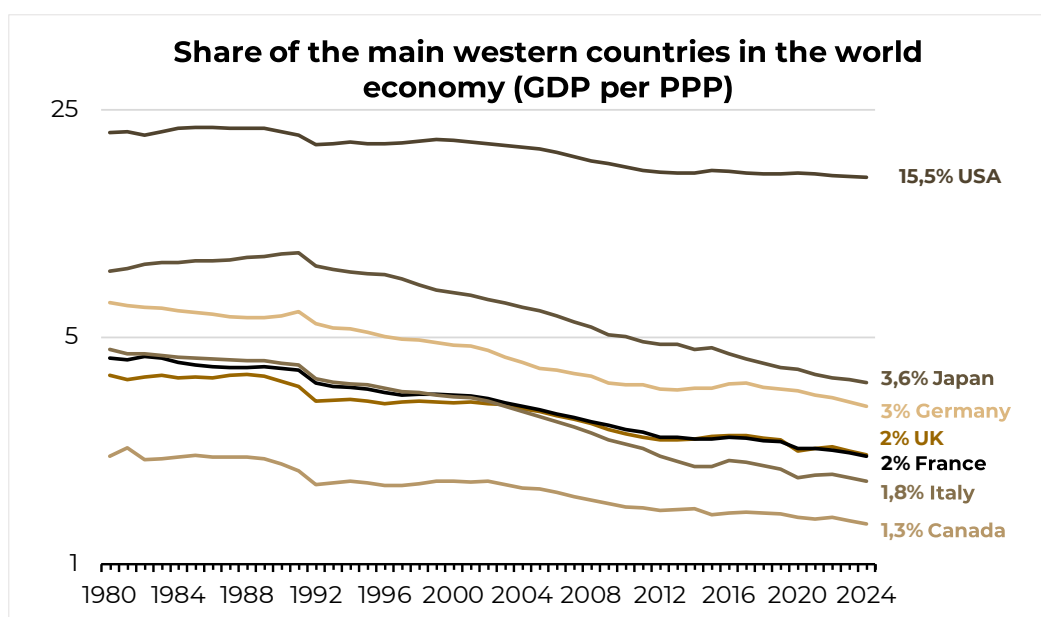


Fig. 1. Share of the main western countries in the world economy (GDP per PPP).
Source: International Monetary Fund. GDP based on PPP, share of world. Available at: <https://www.imf.org/external/datamapper/PPPSH@WEO/USA/JPN/DEU/GBR/FRA/ITA/CAN> (accessed 20 July 2024).

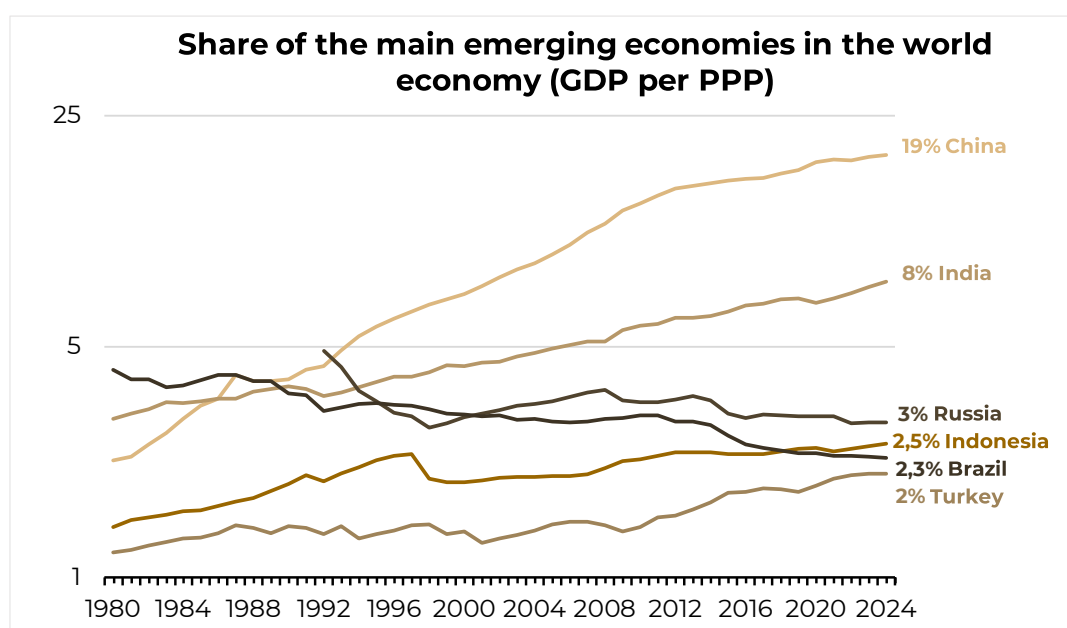


Fig. 2. Share of the main emerging countries in the world economy (GDP per PPP).
Source: International Monetary Fund. Available at: <https://www.imf.org/external/datamapper/PPPSH@WEO/CHN/IND/RUS/IDN/BRA/TUR> (accessed 20 July 2024).

As emerging countries have become significant parts of the world economy in recent decades, they are now willing to play a greater role in the international financial system. Emerging countries, which could now be called new centers of power, have expressed their desire on many occasions to move towards a more multipolar international system, in which no single country would be able to impose its will on others. Therefore, they are not satisfied with this dominant position of the US dollar and would like to move away from the dollar-centered financial system.

A second reason why an increasing number of countries are looking to

challenge the dollar's hegemony is that the USA no longer appears as socially or economically stable as it once did in past decades. In particular, the economic crisis of 2008 served as a stark reminder to the rest of the world that they cannot simply rely on the American economy and the dollar without exposing themselves to significant risks. New centers of power are eager to reduce their dependency on the American economy and currency in case they would encounter another crisis.

Last but not least, the US dollar has increasingly become a weapon of coercion used to unilaterally sanction other countries, as explained in the previous section. While such actions were rare occurrences in the past, they have become more frequent, with the most recent sanctions being imposed on Russia following February 2022. Indeed, each time the USA uses the dollar to sanction a country, it is a double-edged sword, as it encourages other countries that do not support the sanctions to seek alternatives to the dollar in the future.

THE CURRENT STATE OF DE-DOLLARIZATION

As a result, we are recently witnessing many political moves that threaten the dollar's hegemony. First of all, many countries are starting to use their own currencies in international trade. According to Minister of Foreign Affairs of the Russian Federation Sergey Lavrov, more than 90% of the trade between Russia and China is now conducted in their national currencies [5]. In March 2023, Brazil and China announced that they will start trading using the yuan instead of the dollar [6]. On this occasion, Brazil's President, Lula da Silva, declared at the New Development Bank in Shanghai: "Every night I ask myself why all countries have to base their trade on the dollar [...]" "Why can't we do trade based on our own currencies?" [7]. In June 2023, the Kenyan president, William Ruto, denounced the fact that trade between Kenya and Djibouti was issued in dollars and encouraged all African nations to start trading in their own currencies [8]. In May 2023, at the 42nd ASEAN Summit held in Indonesia, ASEAN members signed an agreement to push for the use of local currencies in their trade instead of the dollar [9]. The dollar's role as the international trading currency is increasingly being contested.

Regarding the composition of foreign exchange reserves in the world, we are observing a significant decline in the share of the US dollar since the beginning of the 21st century, as visible in the graph below.

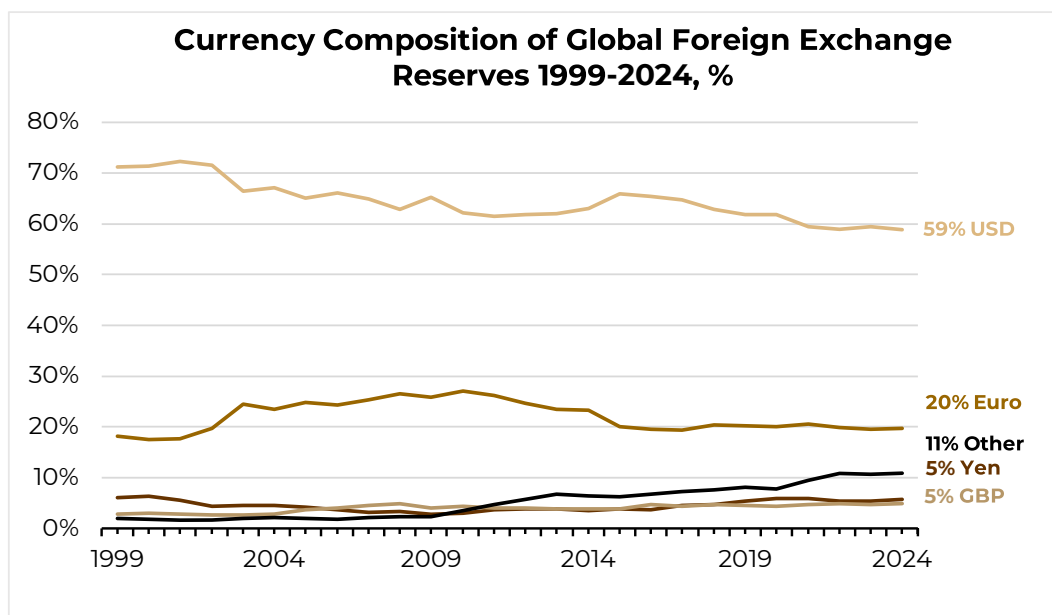


Fig. 3. Currency Composition of Global Foreign Exchange Reserves 1999-2024, %.

Source: International Monetary Fund. Currency Composition of Official Foreign Exchange Reserves (COFER). Available at: <https://data.imf.org/?sk=e6a5f467c14b4aa89f6d5a09ec4e62a4> (accessed 22 July 2024).

Between 1999 and 2024, the share of the US dollar has decreased from over 70% to 59%. The share of the euro has remained relatively stable at 20%. On the other hand, the share of “other” currencies, which was approximately 2% in 1999, increased to 11%. This category includes non-traditional reserve currencies, such as the Canadian dollar (2.5%), the Australian dollar (2%), the Chinese Renminbi (2.5%), and other currencies (4%). Therefore, we are witnessing a decrease in the dollar’s share in favor of these non-traditional reserve currencies over the last 25 years. The process is relatively slow, but it is clear that this trend is ongoing and consistent. As new centers of power continue to play a larger role in the world economy, we can expect this process to continue - and even accelerate - in the decades to come, putting pressure on the US dollar in the international financial system.

In addition, a new challenger to its position might appear soon: a potential BRICS currency. Indeed, the BRICS nations are officially working on a potential new currency that could be used internationally. Alexander Babakov, deputy chairman of Russia’s State Duma, declared that this single currency would be pegged not just to the value of gold but also to other groups of products, rare-earth elements, or soil [10]. A common international currency used by the BRICS+ countries would undoubtedly be a serious threat to the dollar’s role in the world economy.

Even more concerning for the dollar’s hegemony are the recent Saudi-China discussions to sell oil in yuan [11]. The Saudi government may allow China to buy oil in yuan instead of dollars, which would considerably increase the yuan’s credibility on the international scene and end the dollar’s supreme privilege of being the only available currency to buy oil since the US-Saudi agreements of June 1974. If this were to happen, the repercussions on the international system could be considerable, as countries would not need to hold such large quantities of dollars for their energy expenses anymore.

OBSTACLES AND CHALLENGES TO DE-DOLLARIZATION

Despite the will of many countries to end its hegemony, this process is still slow, and the US dollar remains, by far, the dominant currency for multiple reasons.

The main issue is that there is no real credible alternative to the dollar yet. The euro is the second most widely used currency, but the political fragmentation of the Eurozone, as well as limited trust in the economic stability of the Eurozone since the multiple sovereign debt crisis between 2010 and 2012, prevent the euro from becoming a more widespread currency.

In contrast, the Chinese Renminbi has great potential to become a challenger to the dollar’s hegemony. Indeed, China has been the world’s largest economy in GDP calculated per PPP (purchase power parity) since 2016 and is, by far, the main trading nation in the world. However, its currency remains minimally used in the international financial system for multiple reasons. First of all, China imposes significant capital control policies, limiting the ability of investors to freely move money in and out of the country. This restricts the RMB’s liquidity and availability for international users. In addition, the Chinese government often intervenes in the RMB’s exchange rate to influence the currency’s value, creating uncertainty for international investors. Finally, geopolitical tensions involving China and a lack of historical background as a global currency provider limit China’s ability to increase the use of the Renminbi

internationally.

Regarding the creation of new international currencies, such as a BRICS+ currency, for example, they are complicated to establish in the near future. First of all, the economies of BRICS+ countries are very diverse, possessing various characteristics. Therefore, they have competing needs from one another regarding currency interest and exchange rates. In addition, the countries of BRICS+ do not agree on the necessity of challenging the US dollar hegemony. Some countries, like China and in particular Russia, are very eager to challenge the dollar's position. However, other countries like the UAE and India, are on better terms with the US and are willing to maintain a good relationship with them. They would not participate in a project that would seriously endanger their relationship with the US.

Finally, the last obstacle to the de-dollarization process of the world economy is the USA itself. The American elites and government are well aware that their economic power and geopolitical influence are highly dependent on the dollar's hegemony. Moreover, if the global demand for dollars were to be reduced, it would mean that the USA could not sustain its massive trade deficit as well as its budget deficit anymore, resulting in a massive internal economic crisis. If the United States were in a healthier financial state with less debt, the imperative to uphold the dollar's dominance might be less pressing. However, the USA's national debt has considerably risen in the last decades, from 33% of GDP in 1980 to 123% in 2023 [12]. More than ever, maintaining the dollar's dominance is not merely a matter of national pride or economic strategy, but a fiscal necessity to keep the American economy afloat and continue to finance its large deficit. For these reasons, any country that participates in a project aiming to challenge the dollar's hegemony will have to resist considerable political pressure from the USA, which will do anything it can to prevent this process.

CONCLUSION AND FUTURE PROSPECTS

As we reviewed throughout this article, the dominant position of the US dollar in the world economy is increasingly being challenged. Many countries in the Global South are starting to call for the use of their national currencies in international trade, as expressed by President Lula da Silva in Shanghai last year [7]. In addition, if Saudi Arabia and other Gulf countries start selling their natural resources in other currencies, it would pose a serious threat to the US dollar.

Indeed, the process of de-dollarization in the world economy has been initiated, as shown by the evolution of the US dollar's share in the composition of global foreign exchange reserves - from over 70% to 59% between 1999 and 2024. However, the process still faces many obstacles for now. The main problem in achieving significant de-dollarization of the world economy remains the lack of a credible, liquid alternative to the dollar. The Chinese Renminbi still lacks availability, liquidity, and trust for international investors. Regarding a potential future BRICS+ currency, negotiations amongst members are ongoing, but it is unlikely to be implemented in the near future. Because of these limitations, we can expect the de-dollarization process to continue its progression, but at a relatively slow pace in the years to come.

Regarding future prospects, the de-dollarization process of the world economy will be one of the most important geopolitical trends of the 21st century. While it remains complicated to develop a competitive alternative to the dollar, we are witnessing an increasing number of declarations from world leaders, as well as international organizations in recent years that are calling for a move away from the dollar-centered world economy. These signals indicate that important shifts and projects aiming at this goal might appear in the

coming decades. At this moment, America's response to the end of the dollar hegemony will have to be carefully observed, as the USA will resort to all of its coercive power (economic, political, and even military) to prevent it from happening. Indeed, the American elites take this threat against the dollar very seriously, as illustrated by Donald Trump last year in an interview with Tucker Carlson: "if America loses the dollar standard, it would be the equivalent of losing a world war. [...] We will literally be a second-tier country if that happens" [13]. They are well aware that the end of dollar hegemony would have devastating consequences for the American economy and its geopolitical influence. A new large-scale conflict in the coming decades of the 21st century might erupt, not because of a territorial dispute in Ukraine, Taiwan, or the Middle East, but because of a competition of currencies in the world economy.

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About the author:

Marcos Joachim - Consultant, "Kept Tax and Advisory" LLC (Former KPMG). 10 Presnenskaya Embankment Moscow, Russia, 123112, e-mail: joachim.marcos@hotmail.com

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