Trends, reasons and prospects of de-dollarization

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Contents

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I. Introduction

Emerging economies often run trade surpluses while many developed countries have the tendency to carry deficits. As for the United States, it has run persistent and increasingly large current account and fiscal deficits for decades, living beyond its means[2]. However, while developing countries would suffer from economic or debt crisis with severe balance of payment problems, the centrality of the U.S. dollar in the international monetary system allows the United States to escape constraints that the balance of payments would otherwise impose[3]. The U.S. Dollar is not only the world's number one reserve currency, but also the dominant currency for trade invoicing, the leading currency for the issuance of debt instruments, and the top currency for payment clearance. The global financial system is based on the U.S. Dollar. The exorbitant privileges for the United States of such a position have extended much beyond international finance. The U.S. Dollar is a crucial pillar of the global power of the United States, which has intertwined with its hegemonic position since the Second World War.

Historically, there have been attempts by some countries and region to reduce the reliance on dollar, which was dubbed as 'de-dollarization'. But none was broad-based. Unhappiness with the dollar's dominance and the power it grants Washington has been obvious, but none of the de-dollarization efforts till date have achieved meaningful outcome. Therefore, the dominance and supremacy of dollar is still the current global narrative.

However, this time is different, the discontent is more widespread, geographically covering from the Southeast Asia to Latin America and the Middle East. The de-dollarization process has also been multi-pronged, manifested in different areas and channels. Above all, de-dollarization has become part of the policies and strategies for some countries. However, de-dollarization does not mean the demise of dollar is imminent, nor that the sway of the dollar has come to an end. As a matter of fact, currently there is no good alternative to the dollar. Neither is there any substantial evidence to demonstrate that the dollar's supreme status is under threat.

Nevertheless, the disadvantages of overreliance on the dollar have been keenly felt, especially by developing countries. Many countries have started their search for alternatives to dollar in trade invoicing, in foreign exchange reserves, modes of financial clearance, debt issuances etc. De-dollarization also seems to be a reflection of the sentiment and efforts of moving away from the uni-polar world towards a multipolar world in the face of deepening fragmentation, changing narratives and the aspiration for a new and more democratic international economic order.

Owing to the deep-rooted dominance of dollar, the reduction of reliance on the dollar seems to be gradual and incremental, but it has the potential for a critical transformation for the

[2] Catherine L. Mann (1999). On the Causes of the US Current Account Deficit. https://www.piie.com/commentary/speeches-papers/causes-us-current-account-deficit
[3] Cohen, B. (1998). The geography of money. Ithaca, NY: Cornell University Pres. Cohen, B. (1998)

international financial system and carries significant implications for the future of international trade and investment policies.

Historically, a shift from one dominant international currency to another norm has been a slow process[4]. It would be even more so this time. Unlike the overall smooth transition from the Pound Sterling to the dollar, de-dollarization has faced strong resistance and relentless inertia. However, the discontent with the dollar dominance has been mounting. To maintain the status quo does not seem to be an acceptable option. The de-dollarization trend is bound to further deepen and widen.

Following the introduction, Section II discusses mainly the economic rationale, with a very light touch on political reasons, for the current de-dollarization trend. Section III showcases the various modes of de-dollarization led by BRICS and major developing exporters and importers. Section IV briefly reviews the history of dollarization and de-dollarization. Section V elaborates the enormous challenges for meaningful transformation for the dollar-centred international financial system. The final section succinctly highlights the prospects for de-dollarization.

II. Reasons for de-dollarization

Currently, not only states but also investors have been reassessing the role of dollar in the global economy and its implications for the financial system as a whole. The centrality of dollar in the international monetary and economic systems is overwhelming. It is a reserve currency, medium of exchange, and also a unit of account.

II.1. Asymmetry of shrinking US economic weight and growing dominant role of the dollar

The U.S. Dollar's share in international foreign reserves, global trade invoicing, international debt securities and cross border loans are respectively many times that of the share of the US in the global GDP or its share of international trade. As Akinci has pointed out,

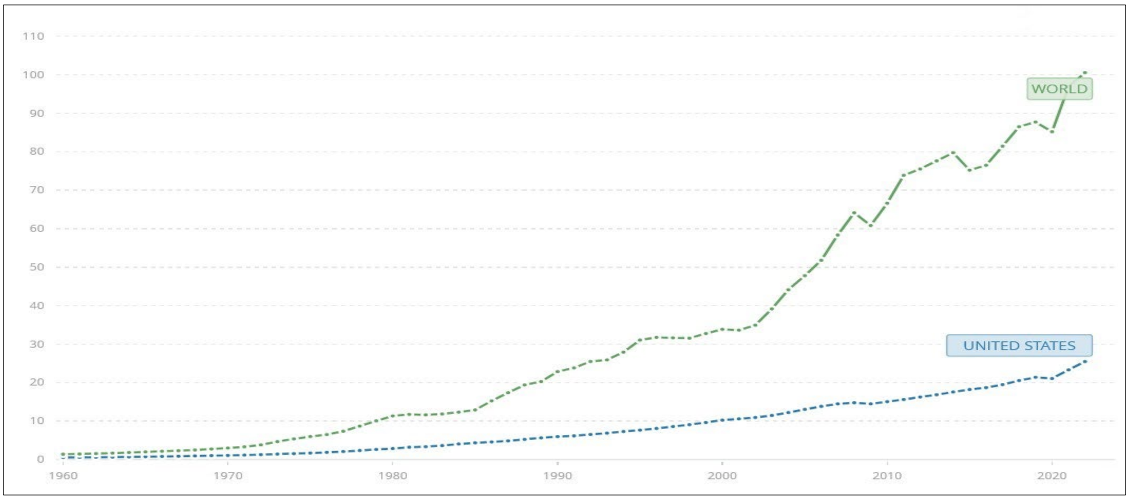
> "*there is a fundamental asymmetry between the shrinking exposure of the "real" U.S. economy to global developments versus the growing global role of the U.S. dollar. …The asymmetry relies on growing dominant role of the U.S. dollar while the U.S. economy is shrinking its importance both in terms of its weight as a share of global GDP and as a share of global trade*"[5].

It is mind boggling to think about the potential risks of one country, whose share of GDP has reduced from around 45 per cent of the world GDP since World War II to the current

[4] Rebecca Nelson and Martin Weiss (2022). The U.S. Dollar as the World's Dominant Reserve Currency, Congressional Research Service. September 15, 2022. https://crsreports.congress.gov/product/pdf/IF/IF11707
[5] Ozge Akinci et al (2022). The Dollar's Imperial Circle, Staff Reports 1045, Federal Reserve Bank of New York. https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1045.pdf

approximately 25 per cent, yet still shoulders an oversized burden or responsibility for the performance of the world economy. Such a concentration of power in one country seems to be scary for the rest of the world. Many scholars also think the current dollar dominated international financial system is skewed in the favor of the United States and is unsustainable. Nouriel Rubini stated that "*sooner or later an alternative will have to emerge to correct this imbalance that has been continuing since the Nixon shock in 1971!*"[6]. President Nixon's unilateral termination in 1971 of the gold standard, which was agreed at the Bretton Woods conference in 1945, gave unchecked power to the United States over the supply of the dollar. From then on, dollar has been printed without the need for collateral.

Figure 1 –The United States and the World GDP (current US$) (in $ trillions)



Source: World Bank

For years, the US government has struggled with a debt burden which is the highest in the world. The US government's most recent debt ceiling standoff in the first half of 2023 made countries consider the possible risk of the government defaulting on its more than 31 trillion US dollar debt. The world's reserve currency relies tremendously on other countries' confidence and trust in its national strength and stability. The twin deficits and heavy debt burden certainly have weakened the country's credibility in the world.

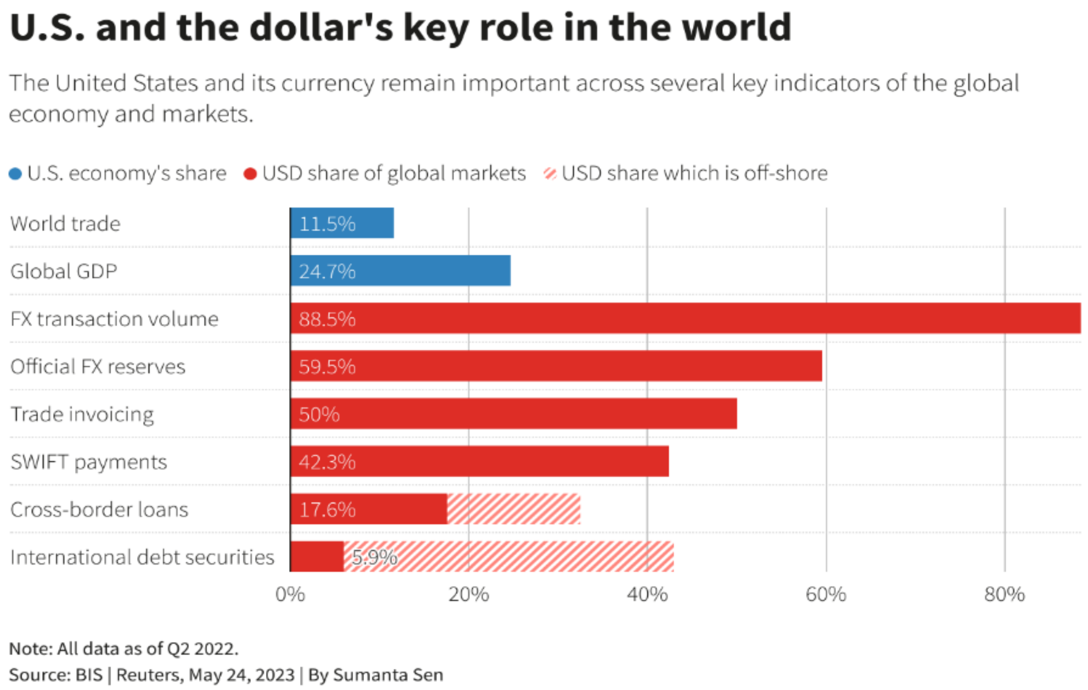
Countries, especially developing ones, have for many times experienced the spillover effects of the appreciation and depreciation of the dollar. They are now trying to cope with the impact of the Federal Reserves' hiking of the interest rates, which has reached a 22-year high and may increase even further[7]. Irrespective of the original aims of interest rates normalization, it has led to depreciation of currencies, huge increase in debt service cost and inflation in many emerging and developing countries.

[6] Nouriel Rubini (2023). A bipolar currency regime will replace the dollar's exorbitant privilege, Financial Times, 5 February 2023.

[7] Steve Matthews, Fed Raises Interest Rates to 22-Year High, Leaves Door Open for More, Bloomberg, 26 July 2023. https://www.bloomberg.com/news/articles/2023-07-26/fed-raises-rates-to-22-year-high-leaves-door-open-for-more

Actions to weaponize the dollar for the promotion of the US foreign policies or to put US economic interests before the rest of the world have been keenly felt or suffered by the rest of the world, in particular developing countries as their resilience to the external shocks is weak. As John Connally, President Nixon's Treasury Secretary said, "*The dollar is our currency, but it's your problem*." Dollar is a national currency, and the United States has full sovereignty to make monetary and fiscal decisions with global implications. Yet, there is no mechanism to compel the national government to consult with other countries which will be at the receiving end of the spill-over effects of these decisions. Neither does the international monetary system have leverage to discipline issuing countries of reserve currencies. This is indeed the problem of the world.

Figure 2



II.2. Transfer of resources via dollar from the periphery to the United States

The supremacy of the US dollar gives rise to global demand for it as a safe asset for foreign reserve and investment. The exorbitant advantage of the dollar allows the US to import foreign goods and services, more often than not at low rates of return, when comparing to a sizeable excess return on US-backed capital exported back to the rest of world including interest income and on portfolio equity positions as well as other exports of capital in dollars.[8] Some scholars have demonstrated that the US earns an important average excess return on its net foreign asset position. Gourinchas and Rey pointed out that U.S. foreign liabilities are almost entirely in dollars, whereas approximately 70 percent of U.S. foreign assets are in foreign currencies. Therefore, a 10 percent depreciation of the dollar represents, *ceteris paribus*, a transfer of around 5.9 percent of U.S. GDP from the rest of the world to the United States. They went on

[8] Caballero, R.J., et al (2020). Global imbalances and policy wars at the zero-lower bound, January 16. 2020, p.9 & Otaviano Canuto, The U.S. dollar's "exorbitant privilege" remains. Policy Brief. Policy Center for the New South. April 27, 2023. https://www.policycenter.ma/publications/us-dollars-exorbitant-privilege-remains

to show that for the period 1952-2004, the indirect capital transfer from the world to the US owing to the special dollar status was "0.3 in 1952 to 0.73 in 1973, reached 1.09 in 1991 and, finally, 1.34 in 2004."[9] Forbes' estimates for US excess returns was much higher and he stated that the 2002-2006 period reached about 6.9%.[10] Meyer on the other hand pointed out that other scholars overlooked the impact on developing countries which suffered more than developed ones and had a net loss by reliance on dollar and estimated that,

> "*Developing economies as a group recorded negative return differentials and valuation losses during 2010–2019, implying a total return differential of about minus three percentage points between developing and developed economies and an annual average resource transfer from developing economies of about \$800bn, or 3.3 per cent of their GDP*"[11].

Overall, all scholars converge that owing to the use of dollar by other countries and US asset position abroad, the average excess return on the net foreign asset by the United States was significant. With these advantages, the negative impact of the current account and fiscal deficits of United States tends to be muted to various degrees to the United States. In other words, the United States can afford to live beyond what its national GDP permits because of the supremacy of dollar. However, this can give rise to economic imbalances in the world as well as vulnerabilities to countries which persistently run trade surpluses including being trapped in exporting of commodities or low-end products of the international supply chain. Huge and persistent trade surpluses mean excessive domestic savings or suppression of consumption, which would result in less productive investment domestically and increasing foreign exchange reserves in safe assets which is largely in dollars. Trade surpluses and less productive investment tends to perpetuate the exports of commodities or low-end exports with low value added. For the United States, trade deficits would lead to more holdings of US treasury bills by trade surplus countries, which in turn lead to more liquidity for the US financial system to intermediate. This kind of imbalance has sown the seeds of financial crisis as the financial system has not been efficient enough to channel liquidity to productive investment, instead giving more appetite for riskier financialization. In addition, US dollar exchange rates and interest rates fluctuations can cause capital market volatilities in developing countries giving rise to flight to safety leading to large capital outflows or short-term capital inflows seeking for high returns. More and more developing countries have realized these risks and uncertainties, which give rise to desire for de-dollarization.

II.3. Exorbitant privileges and "exorbitant" duty of dollar

As mentioned above, to borrow money cheaply in global markets and create money inexpensively domestically, then recycle dollar at higher returns is one privilege of the US dollar. However, the privileges of the dollar go much beyond this.

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[9] Pierre-Olivier Gourinchas and Hélène Rey (2007). From World Banker to World Venture Capitalist: U.S. External Adjustment and the Exorbitant Privilege http://www.nber.org/chapters/c0121 May 2007

[10] Kristin J. Forbes (2010). Why do foreigners invest in the United States? Journal of International Economics Volume 80, Issue 1, January 2010, Pages 3-21

[11] Jorg Meyer (2021), The "exorbitant privilege" and "exorbitant duty" of the United States in the international monetary system: implications for developing countries, Review of World Economics (2021) 157:927–964 https://doi.org/10.1007/s10290-021-00422-5 June 2021. https://link.springer.com/article/10.1007/s10290-021-00422-5

The former Chairman of the US Official Monetary and Financial Institutions Forum had a good summary all the benefits or privileges of the United States derives from the dollar's global financing roles:

> *"The US is largely shielded from exchange risk, whereas other countries must often hedge their currencies. Foreign flows reduce US interest rates, be it for treasuries or corporate paper. Transaction costs are lower. The US benefits from seigniorage, which ultimately helps reduce Treasury financing needs. For better or worse, the US is able to run larger fiscal deficits at lower cost than would otherwise be the case. The US is also able to deploy financial sanctions that can bite. One hopes that the US will run sensible fiscal and financial sanctions policies. The dollar's global role also helps project US economic might across the world*."[12]

The dollar's reserve currency role does make US current accounts biased towards deficits owing to global demands for dollar. This is considered as part of the exorbitant duty of the dollar and repeated often by US officials. Even though demand for dollar could be met through the capital account, which the US normally runs a surplus, or through greater velocity of money through financial institutions creatin quasi money. The US has run persistent deficits for decades. However, it does not seem it would like to follow the IMF advice to suppress domestic demand. In the end this part of the exorbitant duty of dollar may not really constitute a duty. For trade surplus economies, what normally happens is that their banks would intermediate or they would keep high foreign exchange reserves which implies buying dollar denominated assets. This would reinforce dollar centrality and enable the US Federal Reserve to continue to expand credits. This is one of the reasons why emerging economies are attempting alternative currencies for trade invoicing.

Another exorbitant duty of dollar is that the US is expected to assist the rest of the world in times of global economic stress. During the 2007-2009 global financial crisis, which originated from the United States, the US did provide much help to the Euro zone. Therefore, according to the logic, the US would enjoy "exorbitant privileges" during normal times and suffer from "exorbitant duty" of wealth transfer during times of crisis. But Mayor finds that the United States entailed wealth transfers to other developed countries but provided little insurance to developing and transition economies thus the exorbitant duty of the US dollar in providing insurance payments during bad times benefited primarily main developed economies, or "systemically important countries"[13].

[12] Mark Sobel (2021), Exaggerated debate is often conflated with other factors. 1 July 2021. https://www.omfif.org/2021/07/dollars-global-role-extraordinary-privilege-or-burden/

[13] Jorg Meyer(2021), The "exorbitant privilege" and "exorbitant duty" of the United States in the international monetary system: implications for developing countries, Review of World Economics (2021) 157:927–964 https://doi.org/10.1007/s10290-021-00422-5 June 2021. https://link.springer.com/article/10.1007/s10290-021-00422-5

II.4. Weaponization of US dollar and the SWIFT/CHIPS systems

The imposition of sanctions on Russia, which included the freezing of $300bn worth of Russian central bank assets by the United States and its allies, has triggered the fear of Washington using dollar's global dominance as a vehicle for its foreign policy aims. A question being asked is whether the world's reserve currency is supposed to be completely or mostly neutral. Currently, about 40 countries have been sanctioned by the US, of which Cuba has suffered from economic sanctions for more than 60 years. The coverage of sanctions has also become more systemic and wider, affecting not only the central governments but also enterprises and individuals. This has brought financial activities to a standstill and frozen the overseas assets of many institutions, entities and individuals. The joint statement of the BRICS foreign ministers meeting in 2021 stated that "*The Ministers reaffirmed the sole authority of the UN Security Council for imposing sanctions and called for further consolidation and strengthening of the working methods of UN Security Council Sanctions Committees to ensure their effectiveness, responsiveness and transparency.* "[14] Clearly, the view is that sanctions should not be decided by the country with the leading reserve currency.

As a response, while countries were asking who could be the next to be sanctioned, central banks have tried to diversify their foreign exchange holdings, and been pushed to buy more gold. Some have considered that the imposition of U.S. sanctions on Russia has expedited the process of de-dollarization.

III. Ongoing trends of de-dollarization

BRICS countries, other major developing commodity exporters and importers are taking the lead for the current de-dollarization trend. Their efforts have concentrated in the following areas:

III.1. Increasing use of currencies other than dollar in international trade

Global trade has been based on the dollar since the end of the Second World War. Most commodities are priced and traded in U.S. dollars even though the actual trade has nothing to do with the United States. Importing countries have to earn or buy mainly dollars to import their needed goods and services while exporting countries would accumulate primarily dollars in return for their exports. Therefore, international trade increases countries' reliance on the dollar. It is not surprising that an important trend for de-dollarization has been to use alternative currencies to undertake international trade.

Recently, Brazilian president Luiz Inácio Lula da Silva said at the the closing ceremony of the Paris Finance Summit in June 2023 "*Every night I ask myself why all countries have to base*

[14] http://www.brics.utoronto.ca/docs/210601-foreign.html

their trade on the dollar… Why can't we do trade based on our own currencies?"[15]. Lagarde noted that "*Anecdotal evidence, including official statements, suggests that some countries intend to increase their use of alternatives to major traditional currencies for invoicing international trade"*[16]. South Africa's president Cyril Ramaphosa who spoke at the same occasion appeared to support President Lula and said that "*when we have the BRICS summit, the issue of currency is top on the agenda so we are going to discuss it*"[17].

Since the agreement between the United States and Saudi Arabia in 1945, oil trade has always been denominated and conducted in US dollar. Now India has started to purchase Russian oil in Renminbi, Saudi currency and roubles[18]. Russia and China traded Russian oil, coal and metals in Renminbi[19]. Russia and a group of African countries initiated talks to establish settlements in national currencies, discontinuing both the US Dollar and the Euro.
Saudi Arabia, a major oil exporter, has been reported to signal that it is considering trade oil in currencies other than dollar[20]. Ghana, a country in debt distress but the world's sixth largest gold producer, has proposed to import oil with gold, equivalent to barter trade.

Chinese national oil company CNOOC and France's Total Energies completed their first-ever deal of 65,000 tons liquified natural gas imported from the United Arab Emirates in renminbi. The French media considered this marks a major step to undermine the US dollar as universal "petrodollar" for gas and oil trade[21]. China has also established a commodity exchange in Shanghai for oil and gas futures in 2018, the Shanghai Petroleum and Natural Gas Exchange (SHPGX), where contracts are priced solely in Chinese renminbi[22]. Nevertheless, the amount of trading is still very small.

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[15] Joe Leahy and Hudson Lockett. Brazil's Lula calls for end to dollar trade dominance. Financial Times. 13 April 2023. https://www.ft.com/content/669260a5-82a5-4e7a-9bbf-4f41c54a6143

[16] Christine Lagarde, speech at the Council on Foreign Relations' C. Peter McColough Series on International Economics, 17 April 2023. https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230417~9f8d34fbd6.en.html

[17] President Ramaphosa's remarks at Closing Ceremony of the New Global Financing Pact Summit in France, 23 June 2023. https://www.youtube.com/watch?v=bR36kuEzhz8

[18] Nidhi Verma and Noah Browning. Insight: India's oil deals with Russia dent decades-old dollar dominance, Reuters, March 8, 2023. https://www.reuters.com/markets/currencies/indias-oil-deals-with-russia-dent-decades-old-dollar-dominance-2023-03-08/

[19] Chen Aizhu. Vast China-Russia resources trade shifts to yuan from dollars in Ukraine fallout, Reuters, May 11, 2023. https://www.reuters.com/markets/currencies/vast-china-russia-resources-trade-shifts-yuan-dollars-ukraine-fallout-2023-05-11/

[20] Abeer Abuu Omar and Manus Cranny, Saudi Arabia Says Open to Settling Trade in Other Currencies,17 Jan. 2023 https://www.bloomberg.com/news/articles/2023-01-17/saudi-arabia-open-to-talks-on-trade-in-currencies-besides-dollar

[21] 'Petrodollar' at risk as Total Energies sells LNG to China in yuan. 31 March 2023. https://www.rfi.fr/en/business/20230331-petrodollar-under-threat-as-france-s-totalenergies-sells-lng-to-china-in-yuan

[22] Gennifer Gnana, China opens door to trade crude oil and natural gas in yuan, S&P Global, https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/oil/121122-china-opens-door-to-trade-crude-oil-and-natural-gas-in-yuan

For other goods and services, the same trend is going on. Brazil and China signed an agreement in early 2023 to enable mutual trade in local currencies[23]. There is the plan to introduce a Renminbi clearing arrangement for some trade between the two countries. China and Russia are also now doing a significant portion of their trade in yuan.

At an official meeting of all ASEAN Finance Ministers and Central Bank Governors in March 2023 in Indonesia, an issue discussed was how to reduce their reliance on the US dollar and "move to settlements in local currencies" instead[24]. India and Malaysia have started to settle their trade in the Indian rupee[25]. Settlements in national currencies have commenced among the BRICS nations, while Philippines and Thailand have also signed trade deals using non-dollar currencies.

III.2. Diversification of official foreign reserves

In the past two decades, especially since the 2008 global financial crisis, central banks of many counties have been trying to diversify their portfolios to shift away from the US dollar through liquidating holdings of US Treasuries and increasing other assets including the Euro, Yen, renminbi and gold. Since the turn of the millennium,[26] the share of the US dollar in global foreign exchange reserves has declined by more than 10 percentage points (See Figure) from about 71 percent in 2000 to a 20-year low of 58% in the fourth quarter of 2022, according to International Monetary Fund data. Comparing with the peak of 85 percent in 1977, the US Dollar slide in global foreign exchange reserves has been significant but relatively gradual. Taking into consideration that about a quarter of the USD 12 trillion in global official foreign exchange reserves are held by China and cannot be diversified into renminbi, a global shift away from the dollar is quite obvious.

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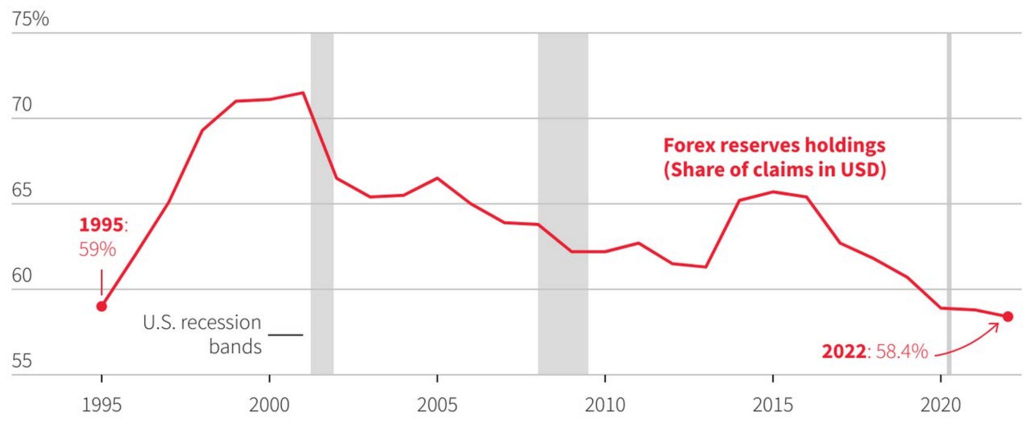
[23] Brasil assina mais de 20 acordos de cooperação em missão empresarial em Pequim, APEXBrazil, 29 March 2023. https://apexbrasil.com.br/br/pt/conteudo/noticias/brasil-assina-20-acordos-de-cooperacao-em-missao-empresarial-em-.html

[24] Chris Devonshire-Ellis, ASEAN Finance Ministers and Central Banks Consider Dropping US Dollar, Euro and Yen, Indonesia Calls for Phasing Out Visa and Mastercard, ASEAN Briefing, 29 March 2023. https://www.aseanbriefing.com/news/asean-finance-ministers-and-central-banks-consider-dropping-us-dollar-euro-and-yen-indonesia-calls-for-phasing-out-visa-and-mastercard/

[25] Kallol Bhattacherjee, India, Malaysia move beyond dollar to settle trade in INR, The Hindu, 1 April 2023. https://www.thehindu.com/news/national/india-and-malaysia-announce-trade-in-indian-rupees/article66687080.ece

[26] European Central Bank, The international role of the euro. June 2022. https://www.ecb.europa.eu/pub/pdf/ire/ecb.ire202206~6f3ddeab26.en.pdf

Figure 3 – Share of U.S. Dollar Reserves held by Central Banks



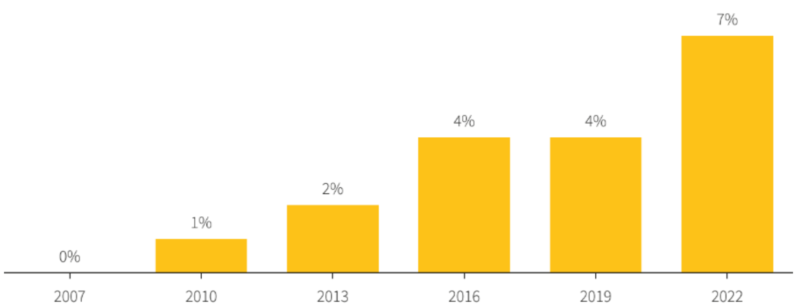
Source: IMF, Refinitiv Datastream | Reuters, May 24, 2023 | By Sumanta Sen

Opposite to the decline of dollar in foreign exchange reserve is the steady and significant rise of the Chinese Renminbi. But as it was at zero more than 10 years ago, its size is no match at all with the dollar. Foreign exchange transactions in Renminbi have increased to 7% in trading volume.

Figure 4

The yuan's steady rise in global FX transactions

Although still small compared to its major peers, the renminbi's share of global foreign exchange transactions has risen from zero to 7% in the last 15 years.



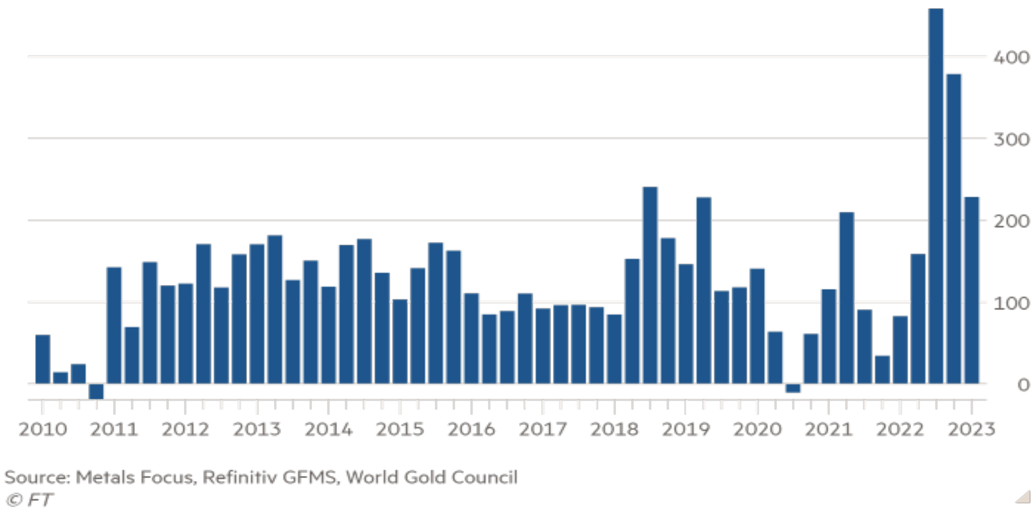
Source: BIS Triennial Central Bank Survey | Reuters, May 24, 2023 | By Sumanta Sen

In seeking a safe alternative to the dollar, central banks have been reducing their dollar holdings, turning to gold and other currencies. The purchase of gold by central banks has reached a peak of 33 per cent of monthly global demand for gold contributing to the sharp increase of the price of gold. 2022 saw the record purchase of gold by central banks of 1,089 tonnes, the most since records began in 1950[27]. In January and February 2023, central banks collectively bought a net 125 tonnes of the metal, the highest amount for the year-to-date period since banks became net buyers in 2010[28]. Russia, China, Turkey and India are among the top buyers of gold. So gold

[27] Harry Dempsey, US banking crisis pushes gold close to all-time high, Financial Times, 5 May 2023. https://www.ft.com/content/b28378f9-adbe-429c-ae16-f6919f96369c
[28] Frank Holmes. Central Banks are buying gold at a record pace so far in 2023. 6 April 2023. https://www.usfunds.com/resource/central-banks-are-buying-gold-at-a-record-pace-so-far-in-2023/

is increasingly becoming a more important alternative reserve asset for central banks while dollar is becoming less important than before for foreign reserves.

Figure 5 – Central Bank Purchases of Gold (Net purchases in tonnes)



Source: Financial Times[29]

III.3. Alternative SWIFT system

Global cross border payments infrastructure is essential for the international financial activities and the realisation of the dominant position of reserve currencies and a very important vehicle for imposition of financial sanctions.

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) is a major Belgian carrier of the messages containing the payment instructions between financial institutions involved in a transaction. Since its establishment in 1977, it has gradually expanded and achieved global dominance in wholesale interbank operations. It works closely with United States' Clearing House Payments Company (CHIPS), which is the network of correspondence banks that owns and operates core payments system infrastructure. Economic sanctions can be carried out by excluding a country's financial institutions from SWIFT or/and CHIPS, (signaling and clearing/settlement processes of financial transactions), which constitutes a major restriction which *de facto* suspends cross-border financial transactions of the countries and their companies from interacting financially in the world. Both CHIPS and SWIFT have been weaponized to implement foreign policies of their owner countries, especially those of the United States.

To deal with this problem, Russia took efforts to develop its own System for Transfer of Financial Messages (SPFS) which is modelled on SWIFT. Recently, Russia has intensified its attempts to use SPFS for cross-border payments. Nevertheless, its use is very limited.

[29] Available from https://www.ft.com/content/b28378f9-adbe-429c-ae16-f6919f96369c

Since 2015, China developed its "Cross-Border Interbank Payment 5 System" (CIPS). The latter which is not modelled after SWIFT but is comparable to CHIPS. It is a complete payment system, incorporating both clearing and settlement. Right now, it still uses SWIFT for most cross-border financial messaging but can be extended to operate by its own. Its coverage is still small but has the potential to be expanded if needed.

France, Germany and the United Kingdom had set up INSTEX in 2019 as "the main response by Europe to the imposition of US sanctions on Iran, designed to enable the [EU countries] to meet their commitments under the Vienna Agreement and the Joint Comprehensive Plan of Action (JCPOA), while helping European companies to continue to do business in that country"[30]. However, it only ever did a single transaction in March 2020 and was subsequently liquidated in March 2023[31].

The Russian and Chinese attempts were stimulated by the increasing use of SWIFT and CHIPS as a tool for sanctions. There are proposals to return "SWIFT to the status of a global public good"[32] to avoid fragmenting international infrastructure for clearing and payments. However, how to implement this is still an issue.

III.4. Common currency

To challenge the dominance of the US dollar and facilitate South-South cooperation, the BRICS nations (Brazil, Russia, India, China, and South Africa) have proposed to establish a common currency. The proposal is to be discussed at the upcoming BRICS summit in August 2023 in South Africa. The immediate goal is to trade with one another directly. Even though this is a complex issue technically and politically, the proposal itself demonstrates the distrust of the dollar and discontent with the current supremacy of the dollar. Brazil and Argentina also announced plans to have a common currency[33].

III.5. Internationalization of domestic currency

China started to internationalize its currency as early as 1993. At that time, there was the intention to gradually push for Renminbi convertibility. When Asian financial crisis hit in 1997, the vehement volatility of capital flow made the Chinese policy makers realized that financial liberalization could lead to great risks. Subsequently, the renminbi's convertibility was postponed and the government, like other East Asian countries, concentrated their attention on accumulating foreign exchange reserve as a buffer against financial crisis. Since then, there have been strides in promoting cross-border payments. RMB trading centers have been set up

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[30] https://www.europarl.europa.eu/doceo/document/E-9-2020-002028_EN.html
[31] https://www.europarl.europa.eu/doceo/document/E-9-2023-001509-ASW_EN.html
[32] Andreas Nölke (2022). The weaponization of global payment infrastructures: A strategic dilemma SAFE White Paper No. 89 | June 2022
[33] Lisandra Paraguassu, Brazil and Argentina to discuss common currency, Reuters, 23 January 2023. https://www.reuters.com/markets/currencies/brazil-argentina-begin-preparations-common-currency-ft-2023-01-22/

in Hong Kong, Asian and European countries to facilitate transactions in RMB. Bilateral and plurilateral trade deals have been agreed to trade in Renminbi. India has also made efforts to trade with other countries in Indian rupees[34]. Brazil, Russia, India, South Africa and Saudi Arabia have all been discussing and engaging in trade in currencies other than the US dollar.

III.6. Digital currency

A central bank digital currency (CBDC) is issued and overseen by a country's central bank. It can help speed up settlement of cross-border transactions once it is mature. According to the IMF,[35] as of July 2022, there were nearly 100 CBDCs in research or development stages and two have been fully launched. Many countries are testing these digital currencies with the aim, among others, of using it in trade transactions in their own currencies. International trade in CBDC could bypass SWIFT or CHIPs. CBDC has the potential to reduce a country's reliance on the dollar in addition to digitalize financing.[36]

IV. Brief history of dollarization and de-dollarization

The U.S. dollar has become the prominent reserve currency since the end of the World War II. In 1944, "the Bretton Woods Agreement" set the rules for a new monetary system and ensured United States dominion over the rest of the planet."[37]. At that time, the United States held about 55 percent of the world's gold reserves. The U.S. dollar was backed by gold and could be redeemed at any time by gold. The value of gold was fixed to $35 per ounce, and the value of the U.S. dollar was thus anchored to the value of gold. Other countries' currencies were pegged to the dollar. This arrangement was called the gold standard, which allowed the United States to expand or contract the money supply against gold. Therefore, free printing of money was not permitted.

In 1945, the United States signed an agreement with Saudi Arabia cementing a close alliance as well as the agreement to denominate the price of oil in U.S. dollar. Following the agreement between the governments of the United States and Saudi Arabia to price oil in dollar, other members of the Organization of Petroleum Exporting Countries (OPEC) followed suit after the establishment of the OPEC in 1960. The emergence of petrodollar boosted demand for the US dollar and further solidified the dollar's position in international trade and the international monetary system. This was the start of petrodollar as well as the beginning to price commodities and international trade in dollar, constituting a big boost to the dominance of the U.S. dollar in international trade.

[34] Vidya Mahambare, Praveen Kumar. Internationalize the rupee while a BRICS currency loses traction. 17 July 2023. https://www.livemint.com/opinion/online-views/internationalize-the-rupee-while-a-brics-currency-loses-traction-11689604699727.html
[35] Andrew Stanley. The Ascent of CBDC. Sep. 2022. IMF, Finance & Development
[36] Maria Demertzis, De-dollarization, 23 April 2023, Bruegel. https://www.bruegel.org/comment/de-dollarisation
[37] Adam Baratta (2020). The Great Devaluation, p. 72.

In 1971, the United States suffered from negative balance of payments difficulties mainly owing to the massive military expenditure on the war against Viet Nam which used up much of U.S.'s reserves of gold,[38] Facing these financial difficulties, President Nixon unilaterally suspended the gold standard, abandoning the free convertibility of dollar into gold. Massive devaluation of dollar followed the decision, materializing a huge transfer of wealth from the world to the United States. However, to the pleasant surprise of President Nixon, other countries did not protest against his decision as they might not be fully aware of its consequence, i.e. the international monetary system is very much in the hands of the United States without the collateral constraint of gold. Benefiting from hindsight, Adam Baratta commented on the suspension of the gold standard and said that,

> "*The unilateral control of the monetary system (author: by the United States) entrenched American dominance across the globe and sealed the fate of every other nation to playing second fiddle to the United States…. Over the past 57 years, the Federal Reserve has expanded the money base 40 times*"[39].

Regarding de-dollarization, the establishment of the Euro in 1999 could be considered as a serious competition to the dollar. According to Henning[40], the Euro was in part created to protect Europe from the disturbances and negative externalities of U.S. monetary policy. But the 2011 Eurozone debt crisis and the structural problems of the monetary union have weakened the Euro's position and made it a distant second international reserve currency to the dollar. Even though it has failed to live up to its potential to meaningfully compete with the dollar as a global reserve currency, without the Euro the world would rely even more heavily on dollar.

The Special Drawing Rights (SDR) was created by the International Monetary Fund in 1969, agreed by all Member States of the IMF. Its purpose is not to compete with the dollar but a way to minimize the burden of the duty of reserve currencies to meet the rising demand of the reserve currencies from the rest of the world. The SDR is not a currency per se but can be held by countries as part of their reserves and converted into currencies when they have balance of payments difficulties. Since 1978, the SDR became an international unit of account. The SDR basket currencies currently comprise US dollar, Euro, Pound Sterling, Japanese Yen and Chinese Renminbi. Some proposed to consider SDR as a reserve currency or as a model for the future international reserve currency system.[41] IMF researchers concurred with the proposal[42]. Shift Three of the United Nations Secretary-General's High-Level

[38] David Graeber (2011). Debt - The first 5,000 years.
[39] Adam Baratta (2020). The Great Devaluation, p. 73
[40] Randall Henning (2003), Systemic Conflict and Regional Monetary Integration: The Case of Europe. Cambridge University Press, 18 August 2003.
[41] UNCTAD Trade and Development Report 2009. United Nations Conference on Trade and Development.
[42] Rooney, Ben (10 February 2011). IMF calls for dollar alternative, CNN Money.

Advisory Board on Effective Multilateralism[43] has recommended that SDR should play a fuller role in the global financial safety net and be a key component of global reserves.

Countries like Venezuela, Iran and Russia have attempted to use currencies other than the dollar to price and trade oil. De-dollarization was the aim of such kind of actions. Further, efforts by some emerging economies including China, Russia and India, etc. to internationalize their domestic currencies for different intentions have the effect of reducing reliance on the dollar. However, they have not constituted a meaningful threat to the dollar so far.

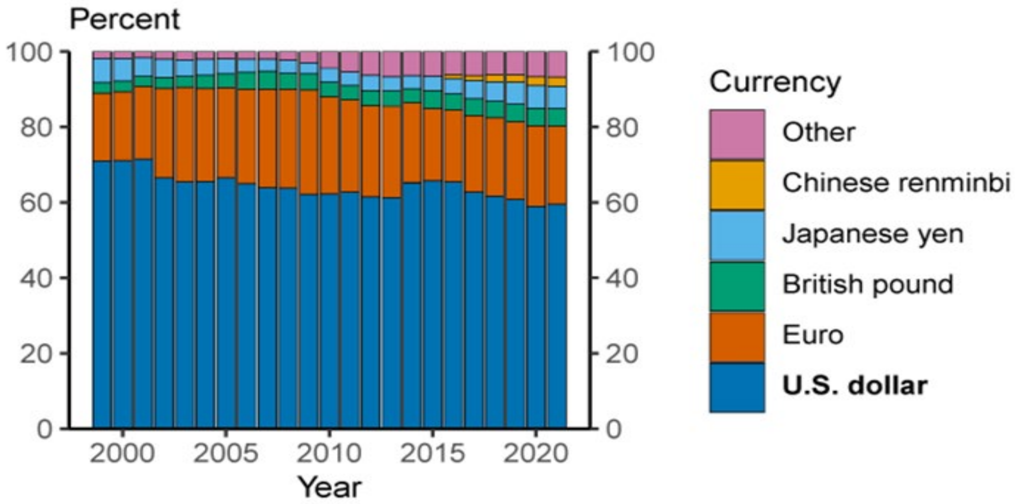
V. Challenges for de-dollarization

Leading reserve currencies are typically characterized by their liquidity, stability, and wide acceptance in global markets. This is because the currency is not just for **a store of value** such as being held as countries' foreign exchange reserves, but also, or more importantly, **a unit and means of payment**–used for trade invoicing, foreign exchange transactions, denominating and trading foreign debt securities and commodities. Therefore, the currency is required to enjoy free convertibility (no capital control or regulations restricting trading), deep and liquid financial market (asset availability at all times), wide network externalities (being accepted widely by countries, financial institutions, private and official investors, exporters, importers, currency traders, debt issuers and lenders, etc.). Using these criteria to assess the major currencies in the world, the dollar still comes by far on the top of the list.

Even though the share of dollar in the world's central banks foreign exchange reserves has declined from the height of more than 70% in the 2000 to the 58% in 2022, back to the level of 1995, it is still dominant. Data from IMF shows that the share of the dollar reserves more than double that of the euro, the distant second in ranking of the most-held currency in the world. The share of the Chinese renminbi in global official foreign exchange reserves has increased relatively fast from very low or zero and has more than doubled since 2016 to almost 3% in 2021 (Figure 6).

[43] High-Level Advisory Board on Effective Multilateralism, Shift Three | Global Finance - Ensure Sustainable Finance that Delivers for All.
https://highleveladvisoryboard.org/breakthrough/pdf/highleveladvisoryboard_breakthrough_Shift3.pdf

Figure 6 - Share and composition of globally foreign exchange reserves (BIS)



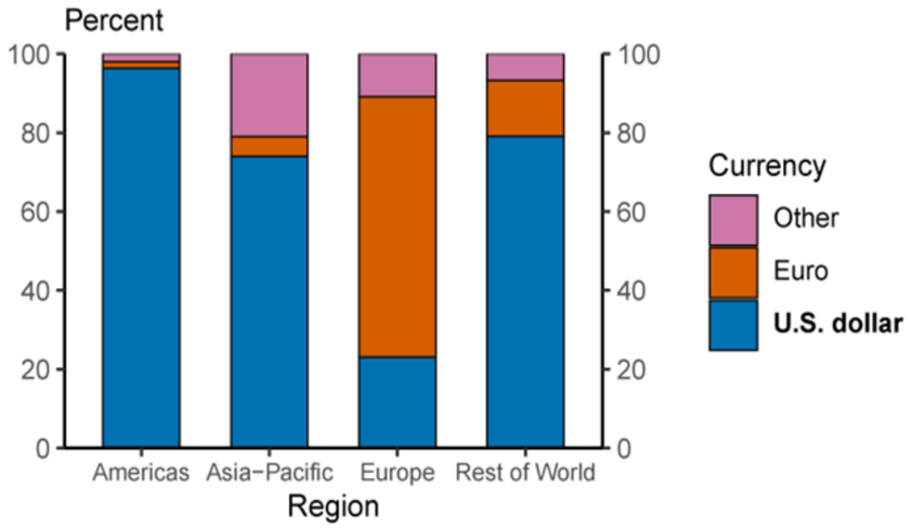
Note: Share of globally disclosed foreign exchange reserves. At current exchange rates. Data are annual and extend from 1999 through 2021. 2021 is 2021-Q1. Legend entries appear in graph order from top to bottom. Chinese renmimbi is 0 until 2015-Q2.
Source: IMF COFER.

The recent decline of the US dollar as a global reserve currency shows the diversification efforts by countries especially the emerging economies. Nevertheless, for trade invoicing and international transaction of foreign exchange, the dollar's position has remained stable, at the level of almost 90% of global forex transactions, representing about $6.6 trillion in 2022, according to BIS data. About 50% of global trade is invoiced in dollar even though US real share in world trade is much less.[44]

Regarding debt instruments, dollar has recently had a significant increase in terms of international bond issuance.[45] According to the BIS, foreign currency debt denominated in U.S. dollars has remained around 60 percent since 2010, while the Euro occupied about 23 to 24 percent in 2021. Regarding cross-border transmissions, over 90% of them were being signalled through SWIFT[46], suggesting an almost absolute monopoly. As for currency composition of SWIFT payments, dollar accounted 43%, Euro 32%, and Renminbi was at 2.3%.[47]

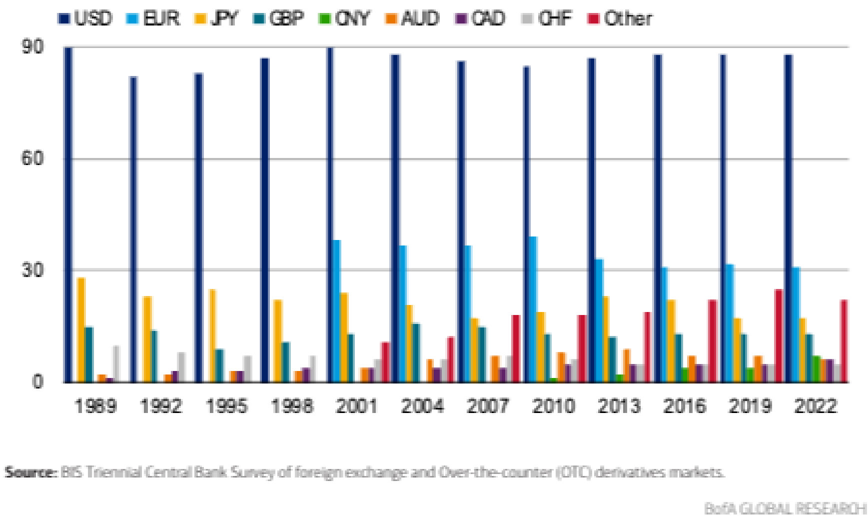
[44] Boz, E et al. (2020), "Patterns in Invoicing Currency in Global Trade," IMF Working Paper no.20/126.
[45] European Central Bank. ECB (2022), "The international role of the euro", June 2022
[46] Nölke, A. (2022), "The weaponization of global payment infrastructures: A strategic dilemma", SAFE White Paper, No. 89, June
[47] Marc Jones, PMorgan flags some signs of emerging de-dollarisation, Reuters. June 5, 2023, https://www.reuters.com/markets/signs-de-dollarisation-emerge-dollar-top-currency-jpmorgan-2023-06-05/

Figure 7 - Share of export invoicing



Note: Average annual currency composition of export invoicing, where data are available. Data extend from 1999 through 2019. Regions are those defined by the IMF. Legend entries appear in graph order from top to bottom.

Figure 8 – Turnover of OTC foreign exchange instruments, by currency (share)



Source: IMF Direction of Trade; Central Bank of the Republic of China; Boz et al. (2020).

On the whole, recent developments, even though broad-based, do not point to any imminent loss of dominance for the US dollar or the Euro. The main regression suffered by the dollar is its around 10% decline in its share in foreign exchange reserves. But on the fronts of foreign exchange transactions, debt issuance outside the United States and SWIFT/CHIPS, the dollar and the Euro, to a lesser extent, have maintained their important leading role.

V.1. Lack of qualified alternative to the dollar

The most important challenge to de-dollarization is that there is no clear alternative single currency which can meet the criteria for being the world's leading reserve currency and be a store of value and a media and means of payment. Leading contenders include the Euro, Yen and Renminbi. However, owing to their own structural problems, the Euro and Yen have been number two or number three key reserve currencies but may not have the capacity to shoulder the entire world by themselves. The Chinese Renminbi despite its impressive progress in internationalization, still lacks deep financial markets, liquidity and wide network. That's why proposals have been put forward relating to a basket of currencies to jointly undertake the task of international reserve currency.

V.2. Resistance from the United States

The United States government has expressed resistance to the de-dollarization trend. Jake Sullivan, National Security Advisor to the US, spoke in April 2023 and spelt out emphatically that the United States has been making arrangement to create an international economic order with "*…America at the heart of a vibrant, international financial system*." This actually is the current *status quo*.. "*The US must sustain its hegemony*", said Sullivan, but "*hegemony, however, is not the ability to prevail—that's dominance—but the willingness of others to follow (under constraint), and the capacity to set agendas."*[48]. However, he did not specify how the U.S. would allow other countries to set agendas and what kind of constraint would be posed to define the boundary and allow countries to follow US lead.

V.3. Geoeconomics

The US dollar and its dominance over the international financial system is not under imminent threat yet. One important reason is geoeconomics. In her speech, Lagarde, based on Weiss's finding[49], mentioned that *"50-60% of foreign-held US short-term assets are in the hands of governments with strong ties to the United States – meaning they are unlikely to be divested for geopolitical reasons."*[50] If countries with some military tie to the U.S are also included, the percentage will increase by a wide margin. The choice of international reserve currencies, therefore, has close correlation with strategic and geopolitical considerations of a country. Eichengreen et al found that military alliances boost the share of a currency in the partner's foreign reserve holdings by about 30 percentage points.[51] For these countries even large scale

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[48] Jake Sullivan, statement, 27 April 2023. https://www.whitehouse.gov/briefing-room/speeches-remarks/2023/04/27/remarks-by-national-security-advisor-jake-sullivan-on-renewing-american-economic-leadership-at-the-brookings-institution/

[49] Weiss, C. (2022), Geopolitics and the US dollar's future as a reserve currency"," *International Finance Discussion Papers*, No. 1359, Board of Governors of the Federal Reserve System, October. 2022 https://www.federalreserve.gov/econres/ifdp/files/ifdp1359.pdf

[50] Christine Lagarde, speech at the Council on Foreign Relations' C. Peter McColough Series on International Economics, 17 April 2023. https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230417~9f8d34fbd6.en.html

[51] Eichengreen, B., Mehl, A. and Chițu, L. (2019), "Mars or Mercury? The geopolitics of international currency choice", Economic Policy, Volume 34(98), April, pp. 315-363.

trade invoicing in currencies other than the U.S. dollar may not be likely to happen. Even if this is going to be the eventuality, countries with strong geopolitical alliance with the U.S. also hold important share of safe U.S. assets. Thus, the dominance of the US dollar would still hold.

VI. Prospects

There are many challenges to meaningful de-dollarization. It seems that it is too early to pronounce that the U.S. dollar's time as the leading reserve currency is coming to an end**.** Overall, de-dollarization efforts have been limited and partial. There has been progress in reducing overreliance on dollar through foreign exchange reserve diversification and trade invoicing as evidenced by the decline in the dollar's share of allocated foreign exchange reserves and the increasing of trade invoiced and transacted in currencies other than the dollar. However, on aspects requiring deep financial market and wide network such as foreign exchange transaction, issuance of debt and payment clearance, the dollar's share has not suffered a decline. Dollar centrality of the international financial system has not yet been threatened by the ongoing trend of de-dollarization. The importance of the Euro has not been threatened either.

Obviously, to increase the resilience of the global financial system, to reduce the imbalances created by relying on a single dominant reserve currency whose issuer's national GDP has been shrinking in the world GDP, the current system needs to be transformed. De-dollarization has the potential to reduce the risks of dollar centrality caused to the global financial system and the world economy including financial volatility, trade imbalances, transfer of resources from developing countries to the reserve currency issuing country. It can also promote a multi-polar world.

A shift away from dollarization does not mean the demise of the U.S. dollar. But the current moves to diversify foreign exchange reserves, increasing trade in different currencies other than dollar, create common currencies, develop alternative payment clearance system would benefit countries in reducing risks of overreliance on the dollar. It may also mitigate the negative impact of unilateral coercive measures on the targeted countries.

This year is the 50th anniversary of the call for a New International economic Order (NIEO). The birth of the NIEO was partly a response to the great dollar devaluation caused by the unilateral termination of the gold standard. Right now, people are revisiting the NIEO. It needs to be pointed out that any discussion of a new NIEO should not omit the issue of de-dollarization or the transformation of the dollar centred international financial system. In the deepening of the de-dollarization process, the BRICS should continue to take the lead as they are major international trading nations, possessing large foreign exchange reserve holdings in dollar and have relatively large GDP in the world.