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Recent De-dollarisation Efforts and the Role of USD

By Elgin Chan

SYNOPSIS

Since World War II, the US dollar (USD) has been the most widely used currency for international commerce and as a principal store of value for central banks. Recently, the USD's hegemonic status in the international monetary system (IMS) has waned to some extent, owing to a confluence of factors. However, the US remains the largest economy in the world with the most developed financial markets and a judicial system that upholds the rule of law, making the USD indispensable in the IMS for the foreseeable future.

COMMENTARY

The US-led International Monetary System

The Bretton Woods system, established towards the end of the Second World War under the leadership of the US, has equipped it with significant influence over the IMS. The USD attained even greater prominence with the signing of the so-called petrodollar agreement between the US and Saudi Arabia in 1973, which led to further demands for the USD and USD assets. In fact, most commodities from oil and gold to coffee and wheat, are currently valued in USD, making it the predominant medium of exchange and unit of account.

Moreover, the Society for Worldwide Interbank Financial Telecommunication (SWIFT), founded in 1973 by 15 countries including the US, and the UK, is now the world's largest international payment and settlement mechanism, covering 11,000 financial institutions in over 200 countries and territories, giving the US enormous influence over the payment system.

The USD currently dominates all foreign exchange products, with at least 85 per cent of foreign exchange trades utilising the USD. The USD accounts for 59 per cent of foreign currency reserves in 2022. Furthermore, approximately 40 per cent of cross-border trades are invoiced in the USD, lending the currency significant influence over international transactions.

Weaponising the US Dollar

In 1965, French President Charles De Gaulle contended that the "*exorbitant privilege*" accorded to the USD provided the US with a range of advantages. The US could essentially weaponise the USD and use it as a carrot and a stick.

The USD has been weaponised on occasions to great effect, as for example, when the US cut off the Russian government and its banks from SWIFT following Russia's invasion of Ukraine. According to the OECD, the removal of Russia from SWIFT and the freezing of nearly half of its US$640 billion foreign currency reserves has led the Russian economy to contract by 3.9 per cent in 2022, and by a projected 5.6 per cent in 2023.

Increasing tensions between the US and China have also put Beijing on high alert. In a 2017 address, Treasury Secretary Steven Mnuchin threatened to impose financial sanctions on China by shutting it out of the USD system if it did not comply with United Nations' sanctions on North Korea. If sanctioned, Beijing's US$859 billion in USD holdings would have been in peril.

Diversifying from the US Dollar

The prospect of the US seizing the assets of those that refuse to heed its directive is alarming, prompting countries to diversify away from the USD. According to IMF's Gita Gopinath, "the sweeping measures imposed by Western countries upon Russia…threaten to gradually dilute the dominance of the USD". Indeed, since the early 2000s, the share of USD reserves held by central banks has declined dramatically from over 70 per cent to 59 per cent as of now, the lowest in 25 years.

With the emergence of a multipolar currency and payment system, concerns about the US' increasing national debt, and the rise of emerging economic blocs that are boosting cross-border trade and investment in their respective national currencies, central banks have increasingly been inclined to diversify into alternative currencies and asset classes.

Indeed, China has added 62 tonnes into its gold reserves while concurrently reducing its USD holdings to their lowest level since May 2009. The Monetary Authority of Singapore has also boosted its gold holdings by 30 per cent earlier this year. Russia's finance ministry announced last December, that it will double the proportion of RMB assets in its National Wealth Fund to 60 per cent.

To circumvent the US-led IMS, and the use of USD for international commerce, many countries have begun to transact in their respective national currencies and to employ payment systems other than SWIFT, such as China's Cross-border Interbank Payment System. Beijing has also bolstered the cross-border use of its Central Bank Digital Currency (e-CNY) via its national programme, Blockchain Service Network, which seeks to provide an alternative to the US-led IMS.

During the 14th BRICS Summit last June, Russian President Vladimir Putin stated that the BRICS countries are "developing a new global reserve currency", which will be based on a basket of the five-nation bloc's currencies. In a further move for the BRICS countries to de-dollarise, Russia has convinced both China and India to pay for oil in Russian rubles or in their own national currencies. Likewise, China and Brazil have recently reached an agreement to conduct bilateral trade, and investments in their own currencies, eliminating the use of the USD as a medium of exchange.

Correspondingly, ASEAN economies have also taken concerted steps to reduce their reliance on the USD, by establishing an alternative payment system and encouraging cross-border commerce in their own national currencies. Last November, Indonesia, Malaysia, Singapore, Philippines, and Thailand, together known as the ASEAN-5, signed a Memorandum of Understanding on cooperation in Regional Payment Connectivity to support and facilitate cross-border commerce, investment, and other economic activities within the region. More recently, the ASEAN-5 has also devised procedures, under the Local Currency Transaction scheme, for conducting business in their own national currencies, reducing their dependence on the USD.

In another push to de-dollarise, President Xi Jinping urged the Gulf states during the China-Gulf Cooperation Council Summit in December 2022, to make full use of the Shanghai Petroleum and National Gas Exchange (SHPGX) as a platform for RMB settlement of energy transactions. In March 2023, the SHPGX announced the first-ever agreement for China to purchase 65,000 tons of liquefied natural gas from the UAE, settled in RMB. Such arrangements might eventually displace the USD as the dominant currency in oil transactions, paving the way for the RMB.

Besides worries about the US government's use of coercion, debt holders have also been anxious about its debt issue since the 2008 global financial crisis. Indeed, Zhou Xiaochuan, Governor of the People's Bank of China, published a paper expressing concerns about the global reserve system being based on the *fiat* USD. The US has amassed more than US$31 trillion in national debt, reaching an all-time high of 129 per cent of its GDP in 2022. Since 1960, the US Congress has had to either permanently increase, or temporarily extend the debt ceiling on 78 occasions, or risk a default.

Future of the US dollar

The emergence of currencies like the RMB, and asset classes like gold, has offered central banks and private investors with alternatives to the USD. These alternatives, however, are unable to replace the USD's dominance because the US remains to boast the largest and most sophisticated economy, the most liberalised and developed financial markets, and a legal system that upholds the rule of law and protects private property rights, making the USD indispensable in the IMS.

China's financial system is still relatively underdeveloped, and there are substantial concerns regarding capital controls and the RMB's convertibility under the authoritarian regime of the Chinese Communist Party. Although gold makes a decent store of value, it does not yield interest, and lacks the liquidity that the USD possesses. The USD will therefore continue to be the predominant unit of account and medium of exchange for international commerce, as well as the central banks' principal store of value, for the foreseeable future.

Elgin Chan is a PhD student at the S. Rajaratnam School of International Studies (RSIS), Nanyang Technological University (NTU), Singapore. Chan's research interests include international political economy, international finance institutions, and global financial architecture.

S. Rajaratnam School of International Studies, NTU Singapore
Block S4, Level B3, 50 Nanyang Avenue, Singapore 639798
T: +65 6790 6982 | E: rsispublications@ntu.edu.sg | W: www.rsis.edu.sg