Why countries want to de-dollarize the international economy?

US monetary tightening is playing havoc with the world's economies as the dollar is the main global currency. This has reignited a desire to end the dollar's dominance in the world economy

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Representative image

The Ambassador at Large of Russia's Foreign Ministry Pavel Knyazev recently announced that the BRICS nations were working together to de-dollarize international trade, replacing it with a new currency based on a basket of the group's currencies. While political reasons including US-led sanctions and disqualification from utilization of SWIFT cannot be ruled out as a credible threat to countries opposing US hegemony, there may be some strong *economic* motivations that provoke countries to look for an alternative to the dollar's dominant position in the international economy.

The first, of course, is the 'exorbitant privilege' that the US has because it can fund its imports with its own currency or more generally, its own financial liabilities or dollar-denominated bonds. To put it bluntly, while the rest of the world must 'earn' dollars to fund their imports, the US need not do so to buy goods and services from the rest of the world.

It might seem that by issuing their financial liabilities (dollars), the US is indebted to the world or that the world is funding US trade deficits. Concerns are raised as to what would happen if China or other countries were to call in US debt. Could the US face a crisis? These are, however, naïve arguments once we understand that the dollar is to the world what the rupee is to India or the real to Brazil. The government of an economically sovereign country is the issuer of its own currency or legal tender and cannot be compared to private sector entities. Governments settle their financial liabilities only through the issue of their own financial liabilities. Debt is simply rolled over. In quite the same way, if China were to call in US debt, the Fed will settle it by issuing new debt. There is no promise to settle it with gold, silver or anything else.

There is one difference though between an economically sovereign country that issues its own legal tender and the US dollar as the global reserve currency. A sovereign country can legally enforce that all obligations due to it (taxes, fines, etc.) can be settled in its currency only and nothing else. This makes legal tender widely acceptable in a country. In the international arena, there is no such mechanism to make the dollar legal tender. The question therefore arises as to why countries accept the dollar as the international medium of exchange?

Access to the massive US market to sustain high domestic GDP growth through exports has prompted nations to accept the exorbitant privilege of the US. This is true for post-World War II Europe followed by Japan and the South East Asian tigers, and more recently, even China. Accumulation of dollar reserves not only allowed them to keep domestic currencies depreciated to encourage exports but also gave them the ability to acquire real assets across the world. At the same time, US trade deficits provided the rest of the world sufficient liquidity for trade among themselves.

The dollar as a 'mutually beneficial' medium of exchange cannot therefore be a strong economic basis for de-dollarization of international trade. Instead, there is another 'exorbitant privilege' of the US that countries are constrained by and seek to escape from: US control over monetary policy, globally. This is evident from the present situation wherein the Federal Reserve (Fed) has hiked interest rates since March 2022 to tame accelerating inflation in the US. The purpose was unequivocal: bring down inflation even if necessitates a recession.

This strategy of the US, however, is not limited to reining in their economy. Most countries have no option but to follow suit: slow down growth to reduce global demand and inflation. First, their central banks have had to hike domestic interest rates to prevent capital flight. This, however, adversely impacts domestic spending and thereby GDP growth. Second, allow the currency to depreciate but face rising imported inflation that may ultimately compel a hike in domestic interest rates or lastly, support the domestic currency through a sale of dollar reserves but then face the risk of speculative attacks on the currency as reserves deplete. Fiscal policy is also impeded as any expansion in spending will only add to inflation and imports thereby drawing the economy into a vicious circle of rising interest rates and currency depreciation.

Keeping Russia out, a look at other BRICS nations reveals why countries may be seeking policy space, breaking free from US priorities over inflation. India's predicament since the Fed's interest hikes are a case-in-point: growth projections have been lowered from 7.2 percent earlier this year to the most recent 5.7 percent for 2022 and a further decline to 4.7 percent in 2023 (UNCTAD). The rupee has been steadily depreciating in spite of hikes in the repo rate by the Reserve Bank of India (RBI). Inflation has still not shown a steady downward trend. South Africa faces a similar predicament as India.

GDP growth rate for 2022 is projected at just about 2.1 percent in 2022. China's growth projections by UNCTAD are down to 3.9 percent and 5.3 percent for 2022 and 2023 respectively even as the yuan has sharply depreciated by around 10 percent in recent months. Brazil has, however, bucked the trend with an appreciation of the real. This, however, has come with a steep hike in interest rates from around 2 percent in the beginning of 2022 to 13.5 percent presently. Real GDP growth projections by UNCTAD are 1.8 percent for 2022 with a sharp deceleration to just about 0.8 percent in 2023.

With Jeremy Powell, Chairman of the Fed, showing no signs of relenting interest rate hikes, the possibility of a global recession cannot be dismissed. At the same time, with control over oil supplies being under the control of a few countries, there are growing doubts whether monetary policy can actually contain inflation since any reduction of demand for oil can be matched by cutting production to ensure elevated oil prices.

It is perhaps this sense of powerlessness over domestic fiscal and monetary policy as well as the political dominance of the US that is driving the current push for de-dollarization of the international economy, and not the benefit that the dollar enjoys as the principal medium of exchange in international trade.

Views are personal and do not represent the stand of this publication.

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