Article

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The Demise of the Dollar

There continues to be much talk of the dollar’s demise and over the last decade, a number of challengers have emerged to lay claim to the dollar’s dominant position. With the rise of China, many consider China to be in pole position to replace the US dollar. The dollar has played a central role in maintaining America’s global position; it has used this position to sanction nations and cut them of from global trade as well as to force nations to support US foreign policy objective.

China has been speaking about replacing the dollar for some time. China’s development has been predicated upon its huge exports to the US, resulting in China accumulating dollar reserves in excess of $3 trillion. In July 2020, the state-owned Bank of China published a report arguing that due to the threat of sanctions from the US, China should make more international payments through its own financial infrastructure.

China’s attempts to move away from the dollar include forming the BRICS bloc. It is trying to initiate the development of its own payment system called CIPS that would be an alternative to the SWIFT system. China also established the Asian Infrastructure Investment Bank (AIIB), as an alternative to the IMF and World Bank in 2014. Successive US presidents placed sanctions on Iran and these sanctions penalised anyone that used dollars to purchase Iranian oil. Donald Trump, during his presidency, warned anyone who traded in dollars with Iran that he would face serious sanctions. Donald Trump, in effect, weaponised the dollar and this spurred China to undertake actions to stop using the dollar. In 2018, the Shanghai Futures Exchange launched its first futures contract that is open to foreign investors. This contract, a Yuan-denominated oil future, has the potential to become a rival to the dollar-denominated Brent and WTI contracts that serve as the current benchmarks.

But while the Chinese Yuan receives a lot of media coverage, the truth is it is not remotely close to being a global currency. In international payments, the Yuan is only used in 1.22% of payments, but the Canadian and Australian dollars are used more in trade. China’s economic model has for long maintained a low exchange rate and, as a result, China only prints limited Yuan and limits access to it to maintain its low exchange rate which helps its exports. China has many restrictions on converting its currency. It has capital controls and its currency is not freely available around the world. When China did make the Yuan fully convertible in 2010, the capital flight was so large and full convertibility was shut down. As a result, until these restrictions are removed, the Yuan cannot become the world’s reserve currency and replace the dollar.

The real challenge with replacing the dollar is that there are no real alternatives currently. Russia’s regular announcements of replacing the dollar with other national currencies and taking oil payments in currencies other than the dollar is all due to US sanctions on Russia after its invasion and occupation of Crimea and East Ukraine in 2015. Russia concluded from this that it must reduce its dependence on the dollar and it has taken some actions to achieve this, but despite trying to reduce its use of the dollar, most nations in the world do not want to buy roubles, which fluctuate widely on the currency market.

The euro is the second reserve currency after the dollar. When the eurozone was created in 1999, many predicted that the euro would overtake the dollar. Since then, the divisions among European countries have become far worse. Investors will be reluctant to put their faith in the euro for fear that the currency bloc could collapse at any moment. Although the euro is traded in huge numbers, it is mostly traded within Europe and is therefore really a local currency, not a global one.

If the Canadian dollar, Australian dollar, New Zealand dollar, Pound Sterling, Swedish Krona and Danish Krone combined and floated a global currency, they would only be able to fulfil around a quarter of global transactions. The global reserve currency needs to be able to lubricate global trade, but these currencies combined cannot fulfil this requirement.

While national currencies have served as global reserve assets, some have argued that the likeliest successor to the dollar could be an entirely new type of currency. Two developing trends, in particular, have the potential to produce non-national international currencies: the Special Drawing Right (SDR), and cryptocurrencies such as bitcoin.

The SDR functions as the internal money of the IMF. It derives its value from a basket of five major currencies: the dollar, yuan, euro, yen and pound sterling. Countries have SDR accounts at the IMF, and they can credit and debit one another using the SDR if they wish to. The fund makes decisions around the basket, such as which currencies are included and what measures to use to calculate its value. In recent years, a proposal emerged to develop the SDR into a currency that could be used by individuals and companies, as at the moment, only countries can use it.

Bitcoin was one of the early leaders in cryptocurrencies. These currencies use a complex system – a distributed ledger mechanism or blockchain technology in which users share the burden of the currency's functioning by offering up their computer power, creating a 'democratic' currency that does not need a central bank to oversee it. A 2015 report showed that bitcoin insiders expected it to become the sixth-largest reserve currency by 2030. But ever since the value of Bitcoins currency has fluctuated wildly due to its volatility and El Salvador the only nation adopting Bitcoin has not proven successful as its national currency, confidence in cryptocurrency to replace existing fiat currencies is far off. Both the SDR and bitcoin face a similar issue: a lack of agency. They both remove a central authority from controlling the issuing of the currency but neither provides the backing that can be afforded by the world's superpower.

The dollar will continue its global position until another nation can internationalise its currency and make it an alternative. Whilst this may seem far off, the US economic situation is rather precarious with its expanding debt, current account deficit and regular government shutdowns. An opportunity may very well arise where an overstretched US facing significant domestic divisions is surprised by another nation quickly increasing its global role and placing its currency in a central position within the global economy. Replacing the dollar therefore becomes more a political issue rather than just an economic one.

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