

De-Dollarization: How Good Or Bad?

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ABSTRACT

The storm is already brewing lately in the international finance arena by some market participants' call for de-dollarization which will lead to the death of the US dollar. De-dollarization is the process of reducing the dominance of the US dollar in global trade and financing activities. Other currencies according to recent data are gaining ground, and the US dollar is no longer the alpha currency it once was. Candidly, the US dollar has over dominated and rendered most currencies of other countries worthless, most especially those of the developing or third world countries, making them further to be under-developed and poorer. The call for de-dollarization is due to the rise of non-US economic blocs and increasing political tensions which have caused countries to rethink their dependency on the US dollar, hence the desire for decreased reliance on the dollar. For this reason, some countries are currently strategizing to promote regional integration and bilateral relations in an effort to protect against geopolitical risks. The paper tries to look at the pros and cons of de-dollarization, the challenges, and the probable way(s) for a common resolve to the issue.

KEYWORDS: *De-dollarization, geopolitical risks, under-development, regional integration, bilateral relations, geopolitical risks, weaponization of the dollar*

HISTORY OF DEDOLLARIZATION

De-dollarization is reducing the US dollar's dominance in global markets by substituting it as the primary currency for various financial transactions, such as trading oil or other commodities, foreign exchange reserves and bilateral trade agreements.

The storied history of the US dollar, originated in the early days of the US, when the US Mint was founded by the Coinage Act of 1792, and established the dollar as the primary currency unit. The dollar's value was initially set relative to gold and silver, and it has since undergone several changes, including adopting the gold standard in 1900 – to enhance price stability and reducing transaction costs in commerce across borders. The US adopted the system with the Coinage Act of 1873, which continued until the Great Depression in the 1930s [1].

The pivotal moment in the US dollar's history was the Bretton Woods Agreement of 1944, as delegates from 44 countries agreed to peg their currencies to the dollar, which was, in turn, linked to gold, helped to

solidify the US dollar's position as the primary trading currency. However, some other factors also led to the rise to prominence of the US dollar as the world's reserve currency. The Federal Reserve Bank was established by the Federal Reserve Act of 1913, which helped maintain price stability in the US dollar. Furthermore, during the World War I, the US became the primary lender for many countries looking to buy dollar-denominated US bonds. Such that by the end of World War II, the US has amassed most of the world's gold reserves, and the Bretton Woods Agreement had solidified the dollar's position as the international monetary standard. With the eventual end of the Bretton Woods system in the early 1970s, the US dollar still retained its status as the world's reserve currency. The factors contributing to its dominance are:

- The stability of its value
- The size of the US economy
- The US geopolitical influence, and
- The unparallel market for US debt.

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As of today, the US dollar is still the currency of choice for international trade and reserves, and while major commodities like oil are primarily bought and sold in US dollars, as shown in Figure 1. It is worth of note that with the recent de-dollarization trend and the emergence of digital currencies, its long-term future as the global reserve currency is uncertain.

US DOMINANCE

The US dollar's leading role in the global economy has granted the US significant influence over other nations. Because of this over-dominance by the US, some countries want to reduce their dependence on the dollar and challenge its dominance to insulate their central banks from geopolitical risks, and one of the groups leading this movement is the BRICS. The BRICS nations, are a group made up of Brazil, Russia, India, China, and South Africa who are making efforts to set up or create a new reserve currency that could compete with the dollar. These five emerging economies in the bloc are working together on various issues, such as trade, finance and development.

THE EMERGENCE OF DE-DOLLARIZATION

Some examples of de-dollarization are [1]:

1. *Emergence of the Petroyuan*: The emergence of the Petroyuan is in response to the longstanding petrodollar system. China, now as the world's top oil importer, has introduced a yuan-denominated oil futures benchmark to stimulate demand for its goods, services, and securities, signaling a potential decline for the petrodollar.
2. *The rise in central bank gold buying*: Gold is being purchased by countries like China, Russia, and India as a means to reduce their dollar holdings. This is a shift in trust from the US dollar to gold to serve as a safer haven, driven in part by the US and its allies' increasing use of financial sanctions.

The weaponization of the US dollar and its role in the continuing de-dollarization trend was discussed by Andy Schectman, President of Miles Franklin, with the Investing News Network (INN) at the 2024 Vancouver Resource Investment Conference (VRIC). He said, ".....we signed an executive order to go green..... we have in essence told the Saudi Kingdom and OPEC, who gives us the dollar hegemony by pricing oil in dollars, that we're going to go green pretty soon, and if you're on the wrong side of us we're going to sanction your funds." It should be noted that these countries reflect the trend toward a multipolar world where other nations are striving to create their own financial systems, lessening their dependence on the dollar. It should also be noted that de-dollarization efforts, while offering advantages

such as risk diversification, stronger national currencies and reduced vulnerability to US sanctions, also present challenges such as transition difficulties, short-term instability and limited global acceptance of alternative currencies. So while de-dollarization presents both opportunities and challenges for the global economy, businesses, investors, and policymakers must understand these implications and adapt to the evolving nature of international trade and finance, as shown in Figure 2 [1].

The weaponization of the dollar is the dollar's unique position which allows the US to wield substantial influence over global financial transactions, giving it the power to impose economic sanctions on entities deemed counter to US interests. According to Mohsin, the exponential increase in U S sanctions usage over the last two decades has prompted allies and adversaries alike to consider alternatives to the dollar. The 9/11 incidence was also fingered to impact on dollar weaponization leading to the US to monitor and control financial flows via the Treasury Department and the USA PATRIOT ACT that established the Terrorism and Financial Intelligence Unit to strengthen Treasuries capabilities in this regard. Furthermore, Mohsin in her book also emphasized that domestic threats pose a greater risk to the dollar than external factors. She argued that the US fiscal deficit, now over \$34 trillion, and deep political divisions are the most significant dangers. The dollar's strength relies on the global faith in the US democratic system and its institutions, and should that faith waver, the dollar's dominant position may weaken [2].

BRICS

BRICS is an intergovernmental organization comprising Brazil, Russia, India, China, South Africa, Iran, Egypt, Ethiopia and the United Arab Emirates. They were originally identified to highlight investment opportunities. Their governments meet annually at formal summits and coordinating multilateral policies since 2009. Relations among BRICS are conducted mainly based on non-interference, equality and mutual benefit [3].

DEVALUATION OF THE DOLLAR

Under the Bretton Woods system established after World War II, the value of gold was fixed for \$35 per ounce, and the value of the US dollar was thus anchored to the value of gold, as shown in Figures 3 and 4. Rising government spending in the 1960s, however, led to doubts about the ability of the United States to maintain this convertibility, gold stocks dwindled as banks and international investors began to convert dollars to gold, and as a result, the dollar's value began to decline. Facing an emerging currency

crisis and the imminent danger that the United States would no longer be able to redeem dollars for gold, gold convertibility was finally terminated in 1971 by President Nixon, resulting in the “Nixon shock” [4, 5]. The value of the US dollar was therefore no longer anchored to gold, and it fell upon the Federal Reserve to maintain the value of the US currency. The Federal Reserve, however, continued to increase the money supply, resulting in “stagflation” and a rapidly declining value of the US dollar in the 1970s. This was largely due to the prevailing economic view at the time that inflation and real economic growth were linked (the Phillips curve), so inflation was regarded as relatively benign [4]. Between 1965 and 1981, the US dollar lost two thirds of its value [6].

RUSSIA INVASION OF UKRAINE

At the start of the Russian invasion of Ukraine, most Western countries imposed heavy sanctions on Russian commodities and banking sector. As a response, on 31 March 2022 Russian President Vladimir Putin signed a decree mandating unfriendly countries from April 1 to pay the natural gas imports in rubles [7]. This was initially rejected by European leaders, marking that such a move would undermine sanctions already imposed on Moscow. However, in April 2022, four European gas companies made trade payment settlements in rubles [8].

FOREX RESERVES

According to the IMF’s Currency Composition of Official Foreign Exchange Reserves (COFER) survey, the share of reserves held in US dollars by central banks fell from 71 percent in 1999 to 59 percent in 2021 [9].

WHY THE DOLLAR CANNOT BE DETHRONED

According to Morgan Stanley, the dollar’s status as the top currency of central banks and for international trade probably is not fading soon. The investment bank has pointed to fears that the US dollar could eventually be dethroned as the world’s top-held most widely used currency. Rivals like the Chinese yuan or the Japanese yen or even a shared BRICS currency could disrupt the dollar’s stats, some commentators have warned, but there are key reasons dollar dominance is not going away anytime soon, Morgan Stanley strategist said.

“Bottom line, King dollar doesn’t really have any challengers,” Michael Zexas, the firm’s head of US public policy research, added. The firm pointed to three factors that will keep the dollar’s top-dog status in the financial markets [10]:

1. The yuan isn’t liquid enough to challenge the dollar

2. Concerns over the US debt won’t affect the dollar and

3. Crypto isn’t a viable alternative.

LIKELY CHALLENGES OR DIFFICULTIES IN THE PROCESS OF DE-DOLLARIZATION

This process of de-dollarization is likely to be very difficult and arduous task due to possible dangers and disruptions that must be carefully evaluated before its implementation. One of the major obstacles is that the new currency may possibly lose its value or credibility. Financial transactions may be hampered and economic instability may result if the new currency is not perceived as being as liquid or stable as the dollar. It is therefore crucial to foster trust and confidence before switching over to the new currency, as shown in Figures 5 and 6.

Another difficulty is that many commodities such as oil and gold are priced and exchanged in dollars, such that moving away from the dollar might make it more difficult to trade these goods internationally. This can therefore restrict finance and direct investment from abroad.

Countries with substantial US debt will encounter additional difficulties as their debts become more expensive if they abruptly abandon the dollar – as financial instability might result from this, making it more challenging to pay back the loan. Moreover, during the transition phase, currency exchange rates may become volatile due to de-dollarization. Therefore, due consideration must be given before the implementation of the de-dollarization plan to thoroughly assess all the potential dangers and disruptions that could occur [11].

CONCLUSION

The US dollar as a global reserve currency will remain the reserve currency much to the detriment of the US economy. The arbitrary use of economic sanctions by the United State Government (USG) and the application of vague and archaic monetary measures as weapons of war has provided the necessary incentive or impetus for much of the world outside the G-7 countries to construct an alternative to the dollar system. This is being done not by challenging it with another type of reserve currency, but through the creation of a decentralized and diverse system of payments and transactions that strengthen local currencies, sustain national security priorities, and increase national economic performance as measured by GDP PPP per capital. However, due consideration and diligence must be applied before the implementation of the de-dollarization plan to thoroughly assess all the likely

and potential dangers and disruptions that could occur.

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Figure 1 International use of the US dollar.

Source:https://www.google.com/search?sca_esv=0d6d888e3e845be0&sxsrf=ADLYWIKhU_VVbNQKbZH XApDbzmXcTHJqKw:1730557390487&q=images+on+de-dollarization+by+wikipedia&udm=2&fbs=AEQNm0Aa4sjWe7Rqy32pFwRj0UkWd8nbOJfsBGGb5IQQO6L3J5MIFhvnvU242yFxzEEp3BcbXWGQjBp6XyyqfUu6Wz8hDrmQY6r35AfNzVfNsL-IsJAaetF9yPOU-SEO5PZfYsNis3jDptA3FnHsJ39fki4iqqzfa8bS3aREzMDiVF3cGeJ4MfM&sa=X&ved=2ahUKEwi0zJfU7L2JAxX_VqQEHQSBGnMQtKgLegQIEhAB&biw=1034&bih=539&dpr=1#vhid=P8UBNJgC87FUQM&vssid=mosaic

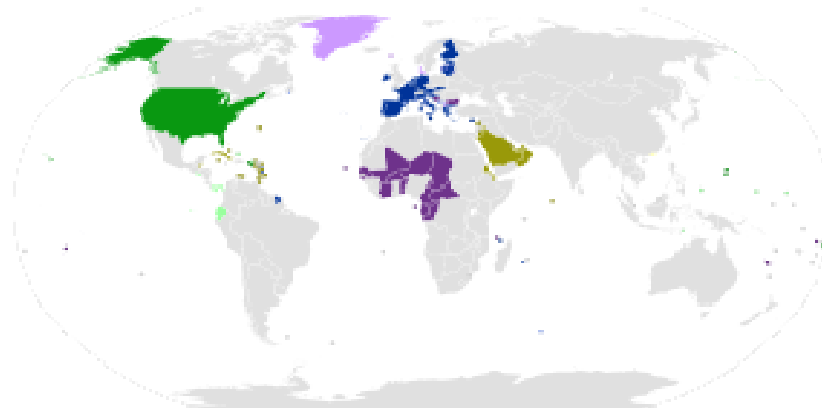


Figure 2 Dedollarization.



Figure 3 United States dollar.

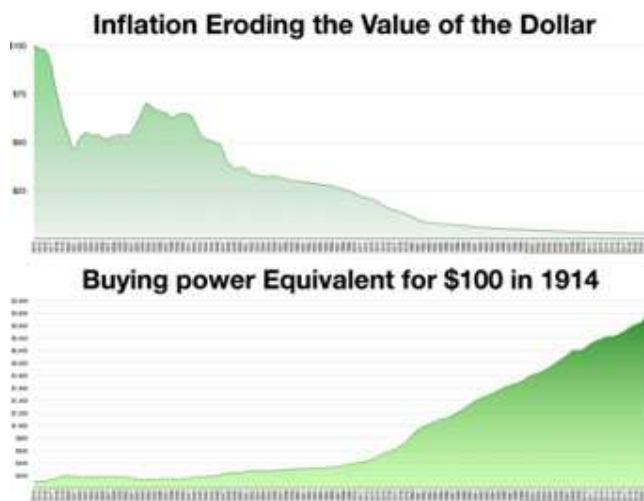


Figure 4 United States dollar.

Source: https://www.google.com/search?sca_esv=0d6d888e3e845be0&sxsrf=ADLYWIKhU_VVbNQKbZH XApDbzmXcTHJqKw:1730557390487&q=images+on+de-dollarization+by+wikipedia&udm=2&fbs=AEQNm0Aa4sjWe7Rqy32pFwRj0UkWd8nbOJfsBGGB5IQQO6L3J5MIFhvnvU242yFxzEEp3BcbXWGGQjBp6XyyqfUu6Wz8hDrmQY6r35AfNzVfNsL-IsJAaetF9yPOU-SEO5PZfYsNis3jDptA3FnHsJ39fki4iqqzfa8bS3aREzMDiVF3cGeJ4MfM&sa=X&ved=2ahUKEwi0zJfU7L2JAXX_VqQEHQSBGnMQtKgLegQIEhAB&biw=1034&bih=539&dpr=1#vhid=_autcJgXFqzfYM&vssid=mosaic

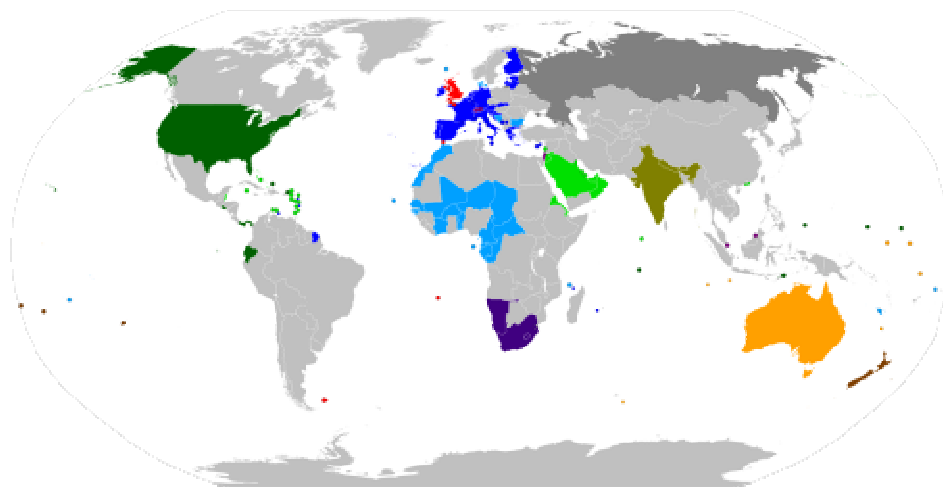


Figure 5 Currency substitution.

Source: https://www.google.com/search?sca_esv=0d6d888e3e845be0&sxsrf=ADLYWIKT5aXTEe-uoReG-pGQhbf-gVGGIA:1730556431317&q=images+on+de-dollarization+by+wikipedia&udm=2&fbs=AEQNm0Aa4sjWe7Rqy32pFwRj0UkWd8nbOJfsBGGB5IQQO6L3J5MIFhvnvU242yFxzEEp3BcbXWGGQjBp6XyyqfUu6Wz8hDrmQY6r35AfNzVfNsL-IsJAaetF9yPOU-

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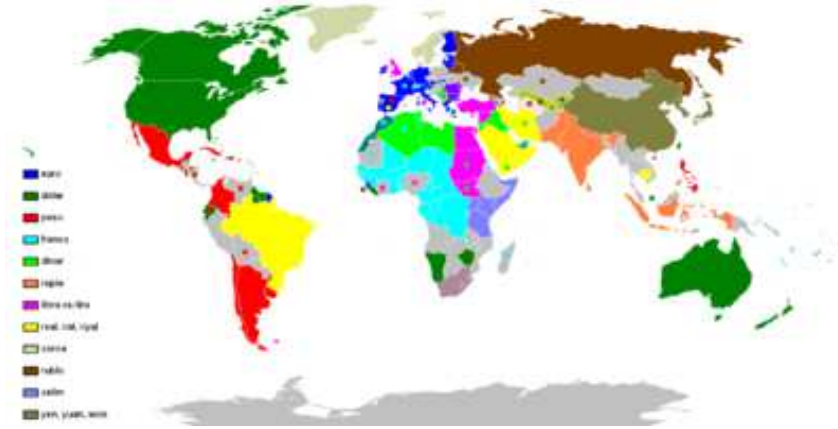


Figure 6 Currency.

Source:https://www.google.com/search?sca_esv=0d6d888e3e845be0&sxsrf=ADLYWIKhU_VVbNQKbZH XApDbzmXcTHJqKw:1730557390487&q=images+on+dollarization+by+wikipedia&udm=2&fbs=AEQNm0Aa4sjWe7Rqy32pFwRj0UkWd8nbOJfsBGG5IQQO6L3J5MIFhvnvU242yFxzEEp3BcbXWGQjBp6XyyqfUu6Wz8hDrmQY6r35AfNzVfNsL-IsJAaetF9yPOU-SEO5PZfYsNis3jDptA3FnHsJ39fki4iqqzfa8bS3aREzMDiVF3cGeJ4MfM&sa=X&ved=2ahUKEwi0zJfU7L2JAxX_VqQEHQSBGnMQtkgLegQIEhAB&biw=1034&bih=539&dpr=1#vhid=30oLuXXQ60ZLZM&vssid=mosaic

