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One currency to rule them all

Once again, the BRICS members are discussing the introduction of their own currency. But breaking the dollar's dominance is unlikely

The representatives of Brazil, Russia, India, China and South Africa arrived to South Africa for the 15th BRICS Summit with big plans. From 22 to 24 August, according to South African Foreign Minister Naledi Pandor, 'the search for alternatives' to the current global balance of power is on the agenda. The goal is a 'changed global order', says Pandor. This also includes measures to push back the dominance of the US dollar in the international monetary and financial system. As early as April, Brazil's President Lula had spoken about this during his visit to China. One possible measure would be the introduction of a common BRICS currency. A possible proposal would be to expand the international role of the Chinese renminbi, as recently brought up again by the Chinese economist Yu Yong Ding. An increased tendency towards this has already been evident since the Russian war of aggression against Ukraine. Since then, Russia has moved more and more towards China and the renminbi.

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The frustration over the dominance of the dollar in the world economy is by no means limited to the BRICS. A number of reasons exist justifying this frustration, which are repeatedly taken up in the politics of the day. First, it is a classic intuition that each country should be able to operate in its own currency. This is associated with the concept of monetary sovereignty. Second, many countries in the Global South cannot borrow in their own currency because potential investors do not believe in the stability of their currency. Therefore, they are forced to borrow in dollars, which puts them in a much worse position. The US, on the other hand, can borrow in its own currency, and US government bonds are considered safe assets in global demand. Thus,

the US budget appears to have no funding limit (except for the obscure debt ceiling of the US Congress, which provides a bit of public drama on a regular basis). Finally, dollar dominance allows the US to use the dollar as a weapon and impose financial sanctions on disagreeable states or companies. This has recently affected Russia, for example, but the EU has also been threatened with financial sanctions, such as when the US under President Trump made a 180-degree turn regarding the agreement with Iran.

Despite these frustrations, a decline in dollar dominance is not very likely. In recent decades, the world has become more multipolar and the influence of the West has declined — but dollar dominance has increased. Indeed, as uncertainty and complexity increase, there seems to be a preference for one dominant currency. The US – and above all its central bank, the Federal Reserve – has proven capable of propping up the global dollar system at crucial moments. In addition, the use of a single international reserve currency in a globalised production, trade and financial system offers crucial efficiency gains. A decline in dollar dominance can therefore only be expected if globalisation levels are noticeably reduced in the world economy or if a major financial crisis, which the Federal Reserve cannot successfully combat, undermines the dollar system from within.

Reasons for the dollar's dominance

The rise of the dollar as the international reserve currency began in the 1930s. Until the First World War, the US acted largely inward-looking. The Federal Reserve was not created until 1913 and the international monetary system was organised from London. The Bank of England was the central institution with the British pound as the international reserve currency. Even then, the international monetary system was a credit money system, but formally, the pound was pegged to gold. Hence, the period is referred to as the classical gold standard.

In the interwar period, the Bank of England tried to reinstate the gold standard. In the early 1930s, however, during the Great Depression, the bank suspended it. Britain was no longer able to maintain its leading role in international monetary relations. The US, on the other hand, was a rising major international power that now systematically relied on an expansion of the dollar. This was accomplished in full after the Second World War. With the help of the Marshall Plan, Europe was ‘dollarised’.

By the 1950s, the European Payments Union existed in the Western bloc. The individual European currencies were not directly convertible into each other but only by means of the dollar as the international reserve currency. In the Bretton Woods system, agreed in 1944, the dollar was also formally given the status of world currency.

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The global expansion of the dollar system continued. The development of the Eurodollar market ('Euro' here stands for 'offshore') in London from the late 1950s onwards enabled banks to create private credit money in the form of dollar-denominated bank deposits outside the US. This phenomenon was viewed critically during the times of the Bretton Woods system, but it wasn't opposed. When the Bretton Woods system collapsed in the 1970s, the private structures of the Eurodollar market replaced the gap created. Large parts of Asia and Latin America were dollarised during that period. After the end of the Cold War, the former socialist states also followed suit in the 1990s.

The dollar system had its greatest test in the 2008 financial crisis, which not only affected the monetary and financial system in the US, but also included a 'run' on US dollars held abroad. During these years, the Federal Reserve showed itself to be determined and capable of acting to prop up the international dollar system. The most important innovation was the introduction of so-called dollar swap lines, with which the Fed provides other central banks – including the European Central Bank – with partly unlimited dollar liquidity. In this way, the Fed effectively acts as a creditor of last resort for dollars even outside the US, which has contributed enormously to the stabilisation of the global monetary and financial system and to the attractiveness of the dollar as an international reserve currency for private investors.

Potential scenarios for the future of dollar dominance

While the dominance of the dollar as the international reserve currency is by no means innate, it has been growing for just under a century due to various political and economic factors. Today, it forms the backbone of the globalised world trade and financial system. When we ask ourselves whether the dollar will remain dominant in the future and whether

alternatives such as a BRICS currency have a realistic chance of containing the dollar's dominance, we should look at whether the structural reasons for dollar dominance persist. Based on this, we can design different scenarios.

The first scenario is the continuation of the current dollar dominance. As long as the trade and financial system remains globalised, there is strong pressure for the use of an international reserve currency that is used in international markets and created through credit money generation worldwide. Other currencies, such as the euro or renminbi, would be used across borders, as they already are in the neighbourhood of the eurozone and China. On a global scale, however, they would not come close to playing a comparable role to that of the dollar as an international currency.

There are good reasons to believe that this is the most likely scenario. In an increasingly uncertain and complex world, dollar dominance has increased, not decreased. The safest haven here always seems to be the US, especially through the Federal Reserve, which has consistently demonstrated its ability to act in financial crises since the 2000s.

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In the second scenario, several competing currency blocs develop. Besides the dollar bloc, this could be a renminbi bloc that positions itself as a counterweight to the monetary hegemony of the US. It is also possible that the euro area could become more independent of the dollar and establish itself as an independent bloc. The global trade and production system would then become more regionalised. There have been tendencies towards this since the Corona pandemic and the Russian war in Ukraine – keyword 'friendshoring'. But whether this will actually bring about structural changes seems rather questionable as things stand today.

The efforts of the BRICS are a clear tendency towards this scenario. Russia had already declared a phase of 'dedollarisation' after the Crimean annexation in 2014. This had been slow, but since the comprehensive financial sanctions and the freezing of central bank reserves after 24 February 2022, this trend has accelerated. Brazil's President Lula da Silva also wants to see the influence of the dollar pushed back in his country. However, China's position on this seems ambivalent. On the one hand, China is clearly striving to increase its economic, political and military

influence and sees the US as its main opponent. A push-back of the dollar hegemony and a strengthening of the renminbi would be fitting for this. On the other hand, China remains firmly embedded in the global dollar system. Its export-driven growth model relies on demand from the US as an integral part. While there are currently growing signs of financial overheating, breaking out of the dollar area would be highly damaging to the country's own economy.

Tectonic shifts in the international monetary and financial system can only be expected if there is a major crash of the existing system. It is unlikely that a fundamental shift away from the US dollar will come through competition from the outside; the collapse, if any, will come from within. Only when the Fed is no longer able to stabilise and guarantee global dollar use can a fundamental change be expected.

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Should such a crash occur, a third (extreme) scenario would be the federalisation of international monetary relations. This could imply that a critical mass of states agree to mandate an international organisation to issue an international currency. While the prospect of such a political agreement is almost utopian, a suitable international organisation for this purpose would already exist. It is not the International Monetary Fund (IMF), but the Bank for International Settlements (BIS) in Basel. The IMF does have special drawing rights, but these are not a world currency in their own right, even if they are sometimes wrongly interpreted as such. The BIS is a bank and can therefore actually create money itself.

A fourth scenario would be the – at least temporary – collapse of the international monetary system after the Federal Reserve and its stabilisation function cease to exist. In this case, it can no longer be assumed that currencies are convertible into each other and that global trade is still possible in the way we are used to today. After a major crash, a window of opportunity could present itself in which a fundamental alternative to the US dollar would prevail, whether another national currency such as the renminbi, or the means of payment of a new monetary union such as the BRICS.

The reasons for today's dollar dominance are historical and have grown over a long period of time. The international use of the dollar has a strong network effect: since everyone else uses the US dollar as an international

currency, alternatives are impractical and have little chance of gaining acceptance. Only instabilities within the system offer room for alternatives, such as in the 1930s, when the era of the British pound as the international reserve currency came to an end, and the dollar started to become its successor.



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