Promoting De-Dollarization

This editorial is based on [“Contesting the hegemony of the dollar”] which was published in The Hindu on 26/01/2023. It talks about the countries' efforts to reduce the prominence of USD in global trade.

For Prelims: Forex reserves, De-dollarisation, BRICS’s New Development Bank, currency swaps, ASEAN countries, SWIFT international system.

For Mains: Steps need to be taken to counter the Dollar Hegemony, Effect of Policies & Politics of Countries on India's Interests

De-dollarisation **refers to reducing the dollar’s dominance of global markets. It is a process of substituting the US dollar** as the currency used for Trading oil and/ or other commodities, Buying US dollars for the **forex reserves**, Bilateral trade agreements, Dollar-denominated assets.

The **dominant role of the dollar in the global economy provides the US a disproportionate amount of influence** over other economies. The US has for long used imposition of sanctions as a tool to achieve foreign policy goals.

The **de-dollarisation is driven by the desire to insulate the Central Banks of the Countries** from geopolitical risks, where the status of the US dollar as a reserve currency can be used as an offensive weapon.

What are the Challenges with Dollarisation?

- **Economic Sovereignty:**
  - Many countries believe that their **economic sovereignty is threatened by the dominance of the dollar in global trade,** as it gives the US government a significant amount of control over the global economy.
- **Currency Manipulation:**
  - The dominance of the dollar in global trade **allows the US government to manipulate its currency** to gain an economic advantage over other countries.
- **Risk of Financial Crisis:**
  - The dominance of the dollar in global trade also **increases the risk of a global financial crisis,** as a crisis in the US economy can have a ripple effect on the global economy.
- **Dependence on US:**
  - Global trade is largely conducted in dollars, so **countries that deal with the US a lot may become too dependent on the US economy.**
- **Geo-Politics:**
  - **Some countries wish to reduce their dependence on the US dollar** as it is seen as a way to reduce the US influence on their economy, and in some cases, as a form of resistance against the US dominance.

What are the Advantages of De-Dollarisation?

- **Reducing Dependence on the US Dollar:**
  - By using other currencies or a basket of currencies, **countries can reduce their dependence on the US dollar and the US economy,** which can help to mitigate the impact of economic and political changes in the US on their own economies.
- **Improving Economic Stability:**
  - By diversifying their reserves, **countries can reduce their exposure to currency fluctuations and interest rate changes**, which can help to improve economic stability and reduce the risk of financial crises.
- **Increasing Trade and Investment:**
  - By using other currencies, **countries can increase trade and investment with other countries that may not have a strong relationship** with the US, which can open up new markets and opportunities for growth.
- **Reducing US monetary Policy Influence:**
  - By reducing the use of the US dollar, countries can reduce the influence of US monetary policy on their own economies.

What are the Challenges with the National Currencies?

- **Not Fully Convertible:**
  - The challenge for national currencies is that **these are not fully convertible.** Thus, despite the rise of alternate systems of trade, and multiple currency circulation systems, the dollar still dominates.
- **Currency Fluctuations**:
  - National currencies can **fluctuate in value relative to the dollar,** which can make it difficult for countries to plan their economic policies and for businesses to make long-term investments.
- **Limited Use of National Currencies in International Trade:**
  - The dollar is **widely used in international trade, making it difficult for national currencies to compete.** This can make it **harder for countries to conduct trade with one another** and for businesses to expand internationally.
- **Dependence on the Dollar:**
  - **Many countries are heavily dependent on the dollar for trade** and financial transactions, which can make them vulnerable to changes in the value of the dollar and to the policies of the US government.
- **Financial Instability:**
  - The dollar's dominance in the international financial system can **contribute to financial instability in other countries,** as they may be more susceptible to financial crises.
- **Monetary Sovereignty:**
  - The **hegemonic role of the dollar limits the monetary sovereignty of other countries** by making it difficult for them to use monetary policy to stabilize their economies.

What are the Steps taken by Governments of Different Countries?

- **Global Efforts:**
  - **Bilateral Currency Swaps:**
    - Bilateral **currency swaps** among **ASEAN countries,** China, Japan, South Korea are USD380 billion and rising.
    - Similarly, the South African rand is used by several African countries.
    - The Latin American countries are moving towards greater inter-regional trade.
  - **Initiation of Trade in National Currencies:**
    - **Asian central banks have over USD 400 billion of local currency swap lines** and trade amongst themselves.
    - The **BRICS's New Development Bank** encourages trade and investment in national currencies by disbursing up to 50% of its loans in national currencies since 2015.

        - China developed the Renminbi in 2015 and offers clearing and settlement services for **participants in cross-border yuan payments and trade.**
        - Russian banks have started using the China-based Cross-Border Interbank Payment System for international payments, as they are debarred from the **SWIFT international system.**
- **India's Efforts:**
    - In July 2022, the Reserve Bank of India (RBI) **unveiled a rupee settlement system for international trade** by allowing special vostro accounts in designated Indian banks, a step towards internationalising the rupee.

What should be the Way Forward?

- **Diversifying Foreign Exchange Reserves:**
    - Governments can reduce their dependence on the dollar by **holding a greater proportion of their foreign exchange reserves** in other currencies, such as the Euro or the Chinese Yuan.
- **Encouraging the Use of Domestic Currencies in International Trade:**
    - Governments can **promote the use of their own currencies in international trade by providing incentives for businesses** to use them.
        - Since 2019, **India has been paying Russia for fuel, oil**, minerals and specific defence imports in rupees on an informal basis.
- **Developing Alternative Payment Systems:**
    - Governments can **work to develop alternative payment systems,** such as the Chinese-led **Asian Infrastructure Investment Bank,** that are not dependent on the dollar.
- **Building Economic Alliances:**
    - Governments can **form economic alliances with other countries to reduce their dependence on the dollar.**
- **Investing in Other Currencies:**
    - Governments may **invest in other currencies to reduce the risk of currency fluctuations** or to counter the hegemony of the dollar.

Drishti Mains Question

To what extent has the hegemony of the US dollar shaped the global economic and political order and how it can be reduced?

UPSC Civil Services Examination Previous Year Question (PYQ)

Q. Recently, which one of the following currencies has been proposed to be added to the basket of IMF's SDR? (2016)

(a) Rouble
(b) Rand
(c) Indian Rupee
(d) Renminbi

Ans: (d)

- Special Drawing Rights (SDR) is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves.
- The value of the SDR is based on a basket of five currencies – US Dollar, Euro, Chinese Renminbi, Japanese Yen, and British pound sterling.
- Chinese Renminbi was added to the basket of currencies on October 1, 2016. Therefore, option (d) is the correct answer.

Q. Consider the following statements: (2019)

1. Purchasing Power Parity (PPP) exchange rates are calculated by comparing the prices of the same basket of goods and services in different countries.
2. In terms of PPP dollars, India is the sixth largest economy in the world.

Which of the statements given above is/are correct?

(a) 1 only
(b) 2 only
(c) Both 1 and 2
(d) Neither 1 nor 2

Ans: (a)

- Due to considerable differences in price levels across economies, market exchange rate-converted GDP does not accurately measure the relative sizes of the economies and the levels of material well-being. On the other hand, Purchasing Power Parity (PPP) make it possible to compare the output of economies and the welfare of their inhabitants in 'real' terms.
- PPP is an economic theory that compares different countries' currencies through a "basket of goods" approach. According to this concept, two currencies are in equilibrium—known as the currencies being at par—when a basket of goods is priced the same in both countries, taking into account the exchange rates. Every three years, the World Bank releases a report that compares various countries, in terms of PPP and US Dollars. **Hence, statement 1 is correct.**
- In terms of PPP Dollars, China ($23.52 trillion) is the largest economy in the world, followed by the United States ($21.4 trillion) and India ($9.56 trillion) at second and third positions respectively. **Hence, statement 2 is not correct.**
- However, in terms of nominal GDP, the United States is the largest economy in the world followed by China. Japan is the third largest economy while Germany and India occupy the fourth and fifth positions respectively. Therefore, option (a) is the correct answer.
