



Mains Practice Question

Q. Global economy is seeing the phenomenon of de-dollarisation. What are the underlying factors driving this trend? In the context of India, what measures can be taken to address the challenges posed by de-dollarisation? (250 words)

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Approach

- Start your answer with a brief introduction about De-dollarisation.
- In body discuss the factors contributing to trend of de-dollarisation.
- Discuss the challenges associated with de-dollarisation.
- Conclude with way forward approach.

Introduction

De-dollarisation refers to **the process of reducing the dominance of the US dollar in global financial transactions**. The trend of de-dollarisation has been witnessed in recent years, with many **countries diversifying their reserve currencies and reducing their dependence on the US dollar**.

Body

Some of the underlying factors driving this trend are:

- **Geopolitical tensions:** The increasing tensions between the US and other countries, particularly China and Russia, have led to a shift in their economic policies towards reducing the reliance on the US dollar.
 - **For instance, US sanctions on its foes cause barriers to free trade.**
- **US economic policies:** The Monetary tightening policies of the US Federal Reserve have led to a flight of capital from other countries to USA, which can **lead to a reduction in foreign investment**, which can affect economic growth.
- **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**.
- **Emerging economies:** Many emerging economies, such as India, China, and Russia, have been investing in their domestic economies, which has led to a shift towards local currencies and reducing the dependence on the US dollar.
- **Increasing use of alternative currencies:** The rise of alternative currencies, such as the **euro, the yen, and the yuan**, has provided an alternative to the US dollar in global transactions.

De-dollarization poses several challenges to countries due to the dominant position of the US dollar in the international financial system. Some of these challenges include:

- **Not fully convertible national currencies:** National currencies are not fully convertible, which means that the US dollar still dominates despite the rise of alternate systems of trade and multiple currency circulation systems.

- **For instance, recently Russia has suspended rupee trade settlement with India due to same reason.**
- **Currency fluctuations:** National currencies can fluctuate in value relative to the dollar, making 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**.

To address the challenges posed by it, India can take the following measures:

- **Diversify foreign exchange reserves:** India can diversify its foreign exchange reserves by investing in other currencies such as the euro, yen, and yuan, which can reduce its dependence on the US dollar.
- **Encourage international trade in local currencies:** India can promote international trade in local currencies, such as the Indian rupee, which can reduce the need for US dollars in global transactions.
 - **India's push for rupee trade settlement** with its trade partners is a step in this direction.
- **Develop domestic markets:** India can develop its domestic markets, particularly the bond market, which can attract foreign investors and reduce India's dependence on foreign capital.
- **Strengthen economic ties with other countries:** India can strengthen its economic ties with other countries, particularly those that are reducing their dependence on the US dollar, **such as China and Russia**, which can provide new opportunities for trade and investment.

Conclusion:

The de-dollarisation trend in the global economy presents both challenges and opportunities for India. By diversifying its foreign exchange reserves, promoting international trade in local currencies, developing its domestic markets, and strengthening economic ties with other countries, **India can address the challenges posed by de-dollarisation and take advantage of the opportunities it presents.**