

## The Moves towards ‘De-Dollarization’ \*

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In the wake of the imposition of sanctions against Russia by the West, following Russia’s opposition to Western designs on Ukraine and Western support to the Ukrainian fascists for carrying out those designs, President Putin has embarked on a course that can potentially have far-reaching consequences for the world economy. He is trying to work out trade deals with other countries which are either themselves facing Western sanctions or are willing to defy them, and the payments on these deals are not in terms of US dollars or even Euros, but in terms of the currencies of the countries entering into these deals.

China and Iran are the obvious partners that Putin is eyeing and [Russia has just entered on May 21 into an agreement with China to the tune of \\$400 billion](#) for supplying gas to the latter over the next thirty years. The significant feature of the deal however is that the payment will not be made in US dollars.

For us in India such arrangements are not new. For decades India had bilateral trade agreements with the Soviet Union and with other East European socialist countries, where the traded commodities exchanged against one another at agreed prices and a given exchange rate, and the trade balance was settled over a period of time without involving any movement of a so-called “reserve currency” from one country to another. Putin has simply taken over an idea that had been put into practice in the days of the Soviet Union.

The advantages of such an arrangement can be understood through a simple example. Imagine country A and country B trading with one another. Every transaction between the two countries would normally have to be settled in terms of a “reserve currency”, say the US dollar. If country A exports \$100 worth of goods to country B over a certain period and has \$30 worth of foreign exchange reserves (in terms of the reserve currency) at the beginning of the period which it can run down, then ignoring each country’s trade with other countries for simplicity, A can buy at the most \$130 worth of goods from B. But if there is a bilateral agreement (supplementing such trade, let us assume) and each accepts the other’s currency as if it is a reserve currency, then A can buy a lot more goods from B. The magnitude of trade would be much larger. When both A and B are hard put to get the reserve currency because of sanctions, clearly bilateral trade agreements can enlarge their trade substantially.

Bilateral trade agreements in effect therefore entail that the two countries entering into agreement treat each other’s currencies as if they are reserve currencies. This means a substantial increase in their foreign exchange reserves and hence trade. The increase is even more substantial when each of the partners has a shortage of the standard reserve currency, either because of sanctions by the advanced capitalist economies, or because of low demand for the goods of each in the advanced capitalist economies, from whom the reserve currency could be earned (which incidentally was the rationale for India’s bilateral agreements with the Soviet Union in the old days).

This substitution of other currencies for the reserve currency which in today's world consists essentially of the US dollar is what the Russians are calling "de-dollarization". To encourage the process Russia has enacted a law whereby companies are required to have a certain minimum percentage of their trade in roubles.

The implications of "de-dollarization" can be quite far-reaching. The dollar which is the reserve currency in the world economy also happens to be a currency that the U.S. central bank, the Federal Reserve Board, can print. It follows then that as long as the dollar remains a reserve currency, the U.S. can run any amount of current account deficit on its balance of payments, and simply print notes to pay for it. True, the other countries may not be willing to hold only the US currency notes but may wish to hold some interest earning dollar asset, such as American Treasury Bills or American government bonds. But when the US central bank prints money, it puts that money into circulation in the economy by buying such assets anyway, in which case if foreigners wish to move from holding dollars to holding these assets, the central bank can simply sell these assets and take back the dollars it had printed. The basic point that the US can run any amount of current account deficit remains valid.

If "de-dollarization" gets going strongly, so that other currencies are held, not just *in addition* to the extra dollars that would be held on account of the US current account of deficit, such as was assumed in the above example, but actually as substitutes for the US dollars in their role as reserves, then this ability of the US to run whatever current deficit it wishes to, gets undermined.

If the US still runs a current account deficit that is larger than what other countries are willing to hold as extra reserves, then the printing of more dollars than anybody is willing to hold would cause a collapse in the value of the dollar. Wealth-holders in such a case will move to other forms of holding wealth, including even commodities, which would cause high inflation, as had happened at the beginning of the 1970s.

On the other hand, if the US reduces its current account deficit to match what other countries are willing to hold as extra reserves, then its absorption of goods will have to decrease, causing a socially-explosive drop in living standards of its population and a loss of its military might. Since it is the leading imperialist power of the world, such a loss of military might has serious consequences.

Either way therefore "de-dollarization" can become a prelude to a new conjuncture entailing severe crisis and destabilization in the capitalist world, and leading to a loss of US hegemony. It is not surprising that the U.S. has always reacted very strongly to any effort by any country to move away from holding dollar reserves to holding reserves in other currencies of the advanced capitalist world. There was even a suspicion that one important [reason for the U.S. invasion of Iraq](#) was Saddam Hussain's reported decision to shift away from the U.S. dollar as the form in which Iraq held its considerable oil wealth.

The trend towards "de-dollarization" is not just confined to Russia and Iran which have both been hit by American sanctions and have good reasons therefore for "de-dollarizing". It covers China as well. China already holds an immense amount of claims on

the US, built over the years through a persistent current account surplus vis-à-vis that country, in the form of dollars or dollar-denominated assets. It is interested therefore in diversifying away from U.S. dollar assets to other forms of wealth-holding such as gold or the Euro, as a means of reducing risks (which arise for instance when all eggs are put in one basket).

China reportedly is already diversifying away from the dollar; and some attribute the recent strengthening of the Euro to such diversification by China. It is also buying gold on a large scale, imitating India in this respect, though in the case of India it is not the government agencies (such as the central bank) but private individuals who are the main importers of gold.

Diversifying away from US dollars however is a tricky operation for China. Since it already holds immense amounts of dollars, such diversification, if it reduces the price of the dollar, can cause large-scale capital losses for China. In such a case, diversification by China would have become a Kalidasa-type exercise of lopping off the branch of a tree on which one is standing. To prevent this, diversification for China has to be stealthy, surreptitious and gradual, so that it does not attract much notice and hence does not cause a fall in the value of the US dollar (which would hurt China itself). China reportedly has been engaged in such a gradual and quiet shift away from the US dollar; and its signing the bilateral agreement with Russia can be seen as one episode in this quiet shift.

The Indian government's attitude, not surprisingly, is totally different from that of Russia, China or Iran, and is much more subservient to the United States. One of the problems that the country would face, if it ever decided to break the US-imposed sanctions against Iran (whatever deviation it currently has from the sanction-regime is with the "permission" of the US, and is based on India's promise that it would only be a temporary phenomenon), is that of obtaining insurance cover for such sanction-busting trade. Apparently even the large public sector insurance companies that could insure such trade, are not large enough to manage such insurance on their own. They go even at present to Western insurance companies to obtain re-insurance for many of the transactions they cover; and the latter would certainly not provide re-insurance if trade was of the sanction-busting kind.

The obvious solution to this problem, and indeed a pre-condition for the country's having a degree of autonomy in its policy towards Western-imposed economic sanctions on third countries, is to make the public sector insurance companies even larger, so that they do not have to run to Western companies for re-insurance. But this requires infusion of government funds into these companies; and the government has steadfastly refused to make such funds available. It does not obviously contemplate getting out of its economic subservience to the United States.

Of course, even in the case of Russia's Putin, it is premature to read much into his current defiance of the U.S. The Russian elite typically sends its fortune to be deposited in the vaults of the Western banks in currencies of the advanced capitalist world, notably the U.S. dollar. Putin's "de-dollarization" therefore would sooner or later run into class opposition by

the Russian corporate-financial oligarchy. How Putin copes with such opposition remains to be seen. But Putin's Russia, for all its anti-American rhetoric, is no Soviet Union. And it would not surprise one in the least if Putin soon capitulates before the West, and calls a halt to the "de-dollarization" drive.

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