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The Move Towards Monetary Multipolarity

Global South Perspectives

Contents

Imperatives of a Multicurrency International Monetary System

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The dollar's dominance, despite the move away from the gold standard, has persisted since the Bretton Woods Agreement in 1944. It continues to command the lion's share of global trade, at around 84%[1] of transactions, while the US share of international trade is much less. As a store of value, it also dominates with 58.36% of all central bank reserves held in dollars.[2] Economists who study reserve currencies tell us that one key ingredient for the making of an international reserve currency is the requirement for strict rule of law. Enforceability of contracts, checks on arbitrary use of power, and democratic accountability through the electorate supposedly provide global confidence that the government of the issuing country will behave responsibly, not abuse its power to artificially manipulate the value of the currency (the big fear being devaluation through fiat or inflationary policies) or confiscate assets held in its currency. However, the regulatory failures leading to the Global Financial Crisis, "the U.S. first" approach to economic policy and monetary choices by the Federal Reserve, and more significantly, the increasing use of unilateral sanctions by the U.S. - in what a former official of the US Treasury Department's Office of Foreign Assets Control (OFAC) describes as its "hidden war"[3] - have shaken the confidence of countries around the world in the durability of the US dollar. Thus, for most countries, the search for alternatives to the dollar is a natural and understandable demand. Indeed, when the chips are down and alternatives are available, even countries allied with the U.S. will support the success of substitutes. As such, the shift to a multicurrency world portends greater economic stability and fairer competition.

1 Jindong Zhang, Winni Zhou and Tom Westbrook, "Yuan overtakes dollar to become most-used currency in China's cross-border transactions," Reuters, April 26, 2023, https://www.reuters.com/markets/currencies/yuan-overtakes-dollar-become-most-used-currency-chinas-cross-border-transactions-2023-04-26/.
2 International Monetary Fund, "Currency Composition of Foreign Exchange Reserves (Cofer)," March 31, 2023. https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4.
3 Juan Zarate, *Treasury's War: The Unleashing of a New Era of Financial Warfare* (New York City: Public Affairs, 2013).

The control paradox: “My currency, your problem”

The unilateral freezing and confiscation of approximately half of Russia’s dollar reserves following its invasion of Ukraine, and Afghanistan central bank funds held in dollars after the Taliban take-over, illuminated the sovereign and systemic risks rising within the international monetary system by the domination of a single reserve currency. The formerly unthinkable risk of reserve currency weaponization, to coerce other countries to follow US foreign policy objectives, or more charitably, its own interpretation of international law, has been realized.

The application of American laws beyond its physical borders has been a matter of controversy and consternation for nations around the world. However, the use of such extraterritorial application, predicated on the status of the dollar, impinges on the freedom of other nations to pursue their national interest through foreign policy choices. Simply put, legal extraterritoriality undermines the very notion of sovereignty. As the Afghan case starkly demonstrates, it also effectively punishes ordinary citizens when a state cannot access its reserves for legitimate trade, development, or meet the basic needs of its people such as essential food and fuel.

Weaponization of sanctions deliberately undermines the polity of nations targeted. Indeed, US officials have made no secret of their aim to seek regime change in Iran, Russia, or Afghanistan by fomenting disaffection through hardships among the people; confiscating dollar reserves and shunning them from international trade. The sanctions cover all dollar-based dealings with these countries and even non-dollar trades or transactions that assist these countries in certain areas (e.g., any investment or dealings related to technologies in the petroleum sector) by punishing third-party sovereign and non-sovereign entities deemed to be involved.

Such unilateral sanctions, originally developed and refined to counter drug smugglers or terrorists, were initially supported by the international community. However, the increasing ferocity of these measures has reached fever pitch in recent years even extending to other traditional great powers. The fact that under US law these are executive decisions to prevent harm means they do away with the legal safeguards that are required in criminal or civil proceedings. As administrative proceedings, they simply require reasonable evidence (as assessed by the decision maker) to freeze accounts or put offending persons or entities on the designated sanctions lists.

Indeed, no prior notice or hearing is necessary as the notice requirement simply alerts the alleged offenders to make alternative arrangements. To the extent of alleged criminality, and as part of the global consensus to fight drugs and terrorism, nations have accepted these measures. However, the use of the same logic in respect of sovereign central bank reserves, and that to bring about changes in the targeted nations' foreign policy or regime change, is untenable and wreaks collateral damage on unintended parties. In this context, summary extraterritoriality is not only an affront to the very notion of sovereignty, but the legality of such actions under international law is highly dubious.

Contested legality of unilateral sanctions

The usual defense of such actions is to resort to the UN Charter, which allows nations to use peaceful means to settle disputes. As international law relies on states to enforce it, the argument made is that a state can use "retorsions or countermeasures" to enforce compliance with international law. It is beyond this short article to thoroughly discuss the legality of unilateral sanctions of the type introduced by the U.S. What is worth noting, however, is that their legitimacy is contested. When do unilateral sanctions constitute "retorsions or countermeasures" that are in conformity with international law? The Draft Articles on Responsibility of States for Internationally Wrongful Acts (2001) prepared by the International Law Commission (ILC) reflect international customary law on the subject. In terms of the principles articulated by the ILC, it is contestable whether unilateral sanctions by a single state, that is not considered an "injured state," are lawful. In the absence of clear jurisprudence on the subject, the net effect is that a powerful state, such as the U.S., is the prosecutor, judge and executioner for the purposes of deciding what constitutes violation of international law and what countermeasures can be taken to force the offending state, and other states, to conform.

Unilateral American sanctions also undermine human rights guaranteed under international law. Indeed, this has led to the appointment of a Special Rapporteur on the negative impact of the unilateral coercive measures on the enjoyment of human rights. In March 2023, the Special Rapporteur, Ms. Alena Douhan, stated that "The United States has for years been imposing sanctions on individuals and entities without national criminal jurisdiction and in the absence of universal jurisdiction. This is clearly a violation of due process rights, including the presumption of innocence and fair trial." The latter rights are guaranteed under the International Covenant on Civil and Political Rights. The Special Rapporteur further stated that, to the extent that the US sanctions prohibit entry to the U.S. and freeze any assets with a US connection, are violative of the rights of movement and are not to be arbitrarily deployed for the deprivation of property.[4]

The primacy of the dollar as the reserve currency of the international monetary system allows the U.S. to weaponize both its access and use. This presents a major dilemma for all nations.

The freezing and seizing of assets: actualizing expropriation

US sanctions have been used to freeze the assets of targeted states including their dollar reserves. Even temporary freezing can severely interfere with a state's ability to meet its obligations, and is, therefore, tantamount to seizure of the asset. There is now open discussion in the U.S. to move beyond freezing of assets. In the increasingly polarized polity of the U.S., where each party is set to outdo the other on proposing extreme measures against *the enemy du jour*, there is serious academic discussion about whether the American President can order seizure once assets are frozen. While there is strong academic opinion suggesting current laws (mainly the International Emergency Economic Powers Act of 1977) do not allow for such seizure, there is significant academic opinion arguing the contrary.[5] Disconcertingly, debate centers around permissibility of such seizure under current US laws rather than on the desirability of such a power and its exercise. Can the world's central banks ignore the possibility of a US president exercising such powers? Ordinarily, this would be inconceivable. However, in the high-stakes political gambit of US electoral politics, the possibility cannot be ruled out.

Whither Europe?

While both the European countries and the U.S. concur on Russian sanctions, it is important to bear in mind the European reaction to President Trump's unilateral repudiation of the Joint Comprehensive Plan of Action (JCPOA),

4 Press Release of UN Office of the High Commissioner for Human Rights, March 9, 2023.
5 Paul B. Stephan, "Seizing Russian Assets." *Capital Markets Law Journal (2022)*, Vol. 17, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4129862.

or the Iran nuclear deal signed by Iran, the Permanent Members of the UN Security Council (China, France, Russia, the United Kingdom, and the U.S.), and the European Union. The effect of US unilateral sanctions was to scupper European investments amounting to hundreds of billions of euros. The threat of locking out European banks and companies from the US financial system was simply untenable. Committed to abiding by the JCPOA, the Europeans could not proceed without risking extreme consequences for their banks and companies. As such, then German foreign minister Heiko Maas called for the creation of a new payments system independent of the United States. In an article published in the *Handlesblatt*, Maas wrote that Europe should not allow the U.S. to act "over our heads and at our expense," adding that "for that reason it is essential to strengthen European autonomy by establishing payment channels that are independent of the U.S., creating a European Monetary Fund and building an independent SWIFT [Society for Worldwide Interbank Financial Telecommunication] system."

European weariness of dollar dominance was not concealed during President Macron's visit to China in early 2023. During his visit, French companies reportedly signed deals allowing payment in RMB, and further reports have shown that payment in RMB was made under one such contract.

Asia's search for a financial safety net

The 1997 Asian financial crisis underscored Asia's need for a financial safety net. To this end, Japan floated the idea of creating the Asian Monetary Fund. The U.S., consistent with its efforts to thwart any regional organizational arrangements that excluded it, pushed back and Japan balked. However, the creation of a financial safety net continued under the ASEAN+3 (Japan, South Korea, China). This led to the Chiang Mai Initiative, a network of swap arrangements that were converted into the Chiang Mai Initiative Multilateralization (CMIM), which is a single agreement for currency swaps. CMIM was complemented by other initiatives such as the Asian Bond Markets Initiative (an arrangement to promote local currency bonds) and the ASEAN+3 Macroeconomic Research Office (AMRO), which was created in 2011 for macroeconomic surveillance. The ASEAN+3 carefully aligned themselves to the IMF, so that under the CMIM only 30% of the agreed amount for any country can be disbursed without an IMF program. It was hoped that these arrangements would pave the way for an Asian Monetary Fund, allowing

Asian countries to tailor solutions to future financial crises. However, regional and global geopolitical shifts have retarded realization of the AMF. The rivalry between Asian countries has intensified due to the US declaration of China as a strategic threat and competitor; a refrain transformed to a chorus and sung by the G7 at their latest meeting in Hiroshima.

Territorial disputes between China, Japan, and India are particularly noteworthy as they have led to fast-changing security arrangements including revival of the quadrilateral alliance (the Quad; Australia, India, Japan, U.S.) and AUKUS military alliance (Australia, UK, U.S.). The emergence of these security alliances and Japan's participation in the U.S.-led "chip war" against China do not bode well for collective financial networks such as the proposed AMF, although the CMIM and AMRO may keep alive the hopes espoused at its genesis.

The 1997 Asian and the 2008 global financial crisis laid bare the risks arising from US economic policies and regulatory failures. Asian countries must, therefore, resort to other measures to manage financial risks arising from the dollar's dominance. The Iranian sanctions and the more recent sanctions following the Ukraine crisis have underscored a more aggressive use of the power arising from the dollar's dominance. In this respect, Asian countries share a common concern with other emerging market and developing nations that have accumulated large dollar reserves as a hedge against financial crises, and whose faith in the international monetary system geared towards dollar supremacy is eroded. Unsuspectingly, they may also find lurking allies among the Europeans. On the face of it, Europe may take short-term comfort in their alliance with the U.S. However, President Trump's repudiation of the JCPOA and subsequent unilateral sanctions levied against Iran still haunt them. It is unlikely that the two main drivers of the European Union, France and Germany, can continue to ignore the European vulnerability to, and dependency on, dollar domination.

Enter the dragon

While the euro has emerged as an international currency, it has suffered a setback since the Global Financial Crisis; even more so considering the unfolding international financial situation that highlights the weakness of the euro vis-à-vis the dollar. The pound sterling is on the decline in a post-Brexit world and the yen has limited potential to grow further as an alternative reserve currency. The serious contender to emerge as a significant alternative is the Chinese RMB. Faced with such situation, China has the economic heft to take on the consequences of a more internationalized currency. Its trading position and increasing domestic demand, predicated on the government's desire to raise per capita income up to $30,000 by 2035, should enable China to raise imports from the rest of the world. While China remains wary of opening its capital account, its experimentation with alternatives, to allow deeper financial markets, is impressive.

With growth of the off-shore RMB market encouraging a "one currency, two markets"[6] model - a network of bilateral swap agreements, the inclusion of the RMB in the SDR basket of currencies by the International Monetary Fund since 2016, the linking of the Shanghai Stock Exchange with the Hong Kong Stock Exchange, and the more recent swap connect - China has created an impressive infrastructure for allowing greater international use of the RMB without opening up its capital account. The roll-out of the digital RMB may further facilitate greater use of RMB globally. The digital RMB also promises to bring down transaction costs as it narrows information asymmetry for users. Since 2015, the RMB's use in international trade has grown significantly (though China still punches well below its share of international trade) given the Belt and Road Initiative (BRI) and its prominent position in international trade. Calls by President Xi for greater use of the RMB for trading oil promise to further increase the currency's prominence. Similarly, according to the IMF, by 2022, RMB use by other central banks had also grown, although it constituted less than 5% of the total reserves of central banks together with pound sterling and the yen.

The modest use of the RMB in international trade and as a reserve has led most commentators and researchers to conclude that there is no imminent threat of de-dollarization. This may be the case, however, what cannot be discounted is a global yearning for the international monetary system to adopt a multicurrency system that one state cannot monopolize or dictate the economic policy or relations of other countries. What may seem like calm today may easily cascade into turbulence. This will depend on how China steers the internationalization of the RMB to give confidence to other countries on its management of the economy, especially policies that effect the value of the RMB, as well as on how the U.S. makes decisions on dollar weaponization. America must also consider prudent management of its economy and polarized politics to mitigate the risk. Its instability should not

6 Edward L.-C. Lai, *One Currency, Two Markets: China's Attempt to Internationalize the Renminbi*. (Cambridge: Cambridge University Press, 2021).

be borne by the rest of the world.

Multicurrency world as a global opportunity

A multicurrency world need not be all negative for the U.S. Being the effective world reserve currency comes at a cost of perpetual current account deficits and financialization of assets at the expense of the real economy. The emergence of other currencies that garner a greater share of world trade and reserve currency can provide the U.S. with the market discipline its real economy needs to generate manufacturing and employment. In the process, a broader burden sharing among several currencies can help the US economy avoid the downside risks that a lop-sided reliance on the dollar creates. A multicurrency international monetary system portends greater stability for the world economy.

De-Dollarization, Beginning of the End?

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Let's face the fact, the world today is dollarized. Most of the world's trade is settled in US dollars. The dollar is ubiquitously usable and certainly welcome everywhere you travel around the world – even including today's Russia, which is essentially engaged in a proxy war against the U.S. Most nations' central banks hold dollar assets as a major part of their foreign exchange reserves. The dollar-based international economic order builds on a global monetary system established after the World War II. But today that system is starting to show signs of cracking, and maybe, just maybe, we are seeing the beginning of the end of the dollar era.

A new multipolar currency system consisting of a few other currencies seems to be slowly emerging. Aside from the euro, the British pound, the Japanese yen, China's RMB yuan is another currency that has seen substantial growth in popularity over the last few years, partly as a result of the Chinese government's effort to internationalize its currency, and partly due to China's increasing weight in the global economic system. Here is a snapshot of the current status of RMB's internationalization level.

First, let's look at the SWIFT system, which is the world's predominant banking transaction system, which accounts for an overwhelming majority of all financial transactions every year. The RMB currently is the fifth most used currency worldwide, accounting for nearly 3% of all SWIFT's payment volume. But it needs to be pointed out that many transactions do not pass through the SWIFT system at all. There are also other payment system alternatives out there built by China and Russia. So, the SWIFT's representation of RMB's worldwide usage is somewhat of an underestimate.

According to data from the People's Bank of China, which is China's central bank, total RMB cross-border trade settlement increased by 17% to nearly RMB 8 trillion yuan in 2021. The proportion of trade settlement in RMB as a percentage of China's own total trade in that year increased to 21% from 18% in 2020.

This is not surprising after all, as China has been the world's largest trading nation for over a decade by now, and also an increasingly important source of foreign direct investment in many other countries, in lockstep with Chinese cooperation projects' expanding global footprint and the government's Belt and Road Initiative.

Another factor driving RMB's expansion has to do with the fact that China has signed bilateral currency swap agreement with several countries, including recently Brazil and Saudi Arabia, and subsequently set up regional RMB clearing houses in these countries to further facilitate the use of RMB.

Aside from the RMB's increasing share as a payment settlement currency in global trade, foreign investors' participation in China's capital markets is another good indicator of the RMB's popularity. Again, according to data from the People's Bank of China as of March 2022, overseas institutional investors held RMB 4 trillion yuan, or 2.9% of the outstanding amount of bonds under custody in China's bond market. In the equity market, overseas institutional investors and individuals held RMB 3.19 trillion yuan of Chinese stocks, an increase of nearly 90% compared to the same period in 2021.

Another gauge of a currency's popularity regards its role as a reserve currency held by foreign governments. In this area, the RMB is also steadily advancing. Shares of RMB holdings in central banks' foreign exchange reserves have seen substantial increase. For instance, Brazil's central bank holds 5% of its foreign exchange reserves in RMB at the end of 2021. Russia is another country where its central bank is betting big on the RMB. Before the conflict in Ukraine, it already put about 14% of its foreign exchange reserves in RMB, and now has increased its share even more significantly as a result of the financial sanctions from the West.

Probably a defining barometer of the RMB's prospects in global financial markets is its share in the International Monetary Fund's (IMF) Special Drawing Rights (SDR). This is a composite currency used as a last resort backup for countries that land in balance of payment difficulties. In the last round of the IMF's review, the RMB's weight has surpassed the British pound and the Japanese yen to reach 12.28%, only after the dollar and the euro.

Notwithstanding the RMB's impressive march towards the international arena, perhaps a more significant development underlying the trend towards a multipolar currency world is the ongoing discussions in many capitals about using regional currencies for trade payment settlements to deliberately bypass the dollar.

A few ASEAN countries have come out to state such a desire. For example, Perry Warjiyo, governor of the Indonesian central bank, said on March 31 at the end of the ninth ASEAN Finance Ministers and Central Bank Governors Meeting in Bali, Indonesia, that using local currencies for cross-border trade and investment would reinforce financial resilience in the region. Indonesia would create a task force to study the feasibility of using local currencies, instead of the dollar, in regional trade.

"There is no reason why countries like Malaysia continue to rely on the dollar," Malaysian Prime Minister Anwar Ibrahim told the Malaysian parliament on April 4. Malaysia is currently negotiating with China to use the RMB and the Malaysian ringgit for bilateral trade settlement. Anwar has also re-proposed establishing an Asian Monetary Fund.

Brazilian President Luiz Inácio Lula da Silva is a big fan of bypassing the dollar. During the visit to the New Development Bank, or NDB, in Shanghai, as a part of his state visit to China, Lula said, "Why can't an institution like the BRICS bank have a currency to finance trade relations between Brazil and China, between Brazil and all the other BRICS countries? Who decided that the dollar was the currency after the end of gold parity?" Expectedly, China and Brazil signed an agreement to use RMB and Brazilian real in bilateral transactions in March this year.

Believe it or not, the trend towards de-dollarization is also being actively pushed by the U.S. itself as well, as manifested in its numerous sanctions against several countries, most notably Russia and Iran these days, both of which are important oil producing countries. The war in Ukraine, the resulting sanctions and the confiscation of Russian assets by the West further inflicted great damages to the stature of the dollar, as US Secretary of the Treasury Janet Yellen once pointed out. Even assets of private citizens of sanctioned countries are now in danger of being confiscated. That scared the hell out of a lot billionaires to stay out of the dollar.

The West's sanctions against Russia have also caused a rapid run-up of key commodity prices, leading up to high-flying inflation in Europe and the North America. Russia is a major supplier of a few key agriculture commodities and strategic mineral resources. Since last year, the US Federal Reserve's interest rate hike campaign as a means to fight inflation has undergone several rounds already. Predictably the dollar has rapidly appreciated, resulting in an exodus of capital around the world back to the U.S. The moves of the Federal Reserve have generated adverse international impacts. Many countries have been trapped into crises of currency depreciation, capital outflow and imported inflation.

The worsening of the balance of payment situation in many countries has caused many economists in these emerging market economies to propose to counter the risk imposed by the dollar by preparing for a multipolar currency world. Aside from advocating alternative currencies to settle trade, they are also advocating reducing holdings of US Treasury bonds, bilateral currency swap agreements, bloc monetary fund, regional currency cooperation, etc.

In short, we have articulated about some of the economic forces underlying the trend toward de-dollarization and a multipolar currency world. But realistically speaking, this could be a long process in the making. Even a piece of worthless green paper that nevertheless used to rule the world would still take some time for the market to discover its true value. There are historical precedents.

Historically debased coins took a bit of time to be driven out of the market. For example, the wicked trick of wholesale exports of debased coins to foreign states was indeed practiced in the seventeenth century in Europe, lasting almost two decades. At the time, French, Italian and Dutch merchants shipped across the Mediterranean about 200 million pieces of mostly copper coins with a thin silver coating, called luigini, as silver money in exchange for Ottoman imports. This created a bizarre but legendary chapter in the numismatics history that some Turkish economic historian described as the "biggest counterfeiting scheme in history!"

Today the greenback is printed of course. All currencies are printed for that matter. What's driving their popularity is fundamentally the strength of the economy standing behind them. In that regard, probably the most promising currency likely to take a bite out of – certainly not replace – dollar's lion share among several currencies in the global monetary system is still China's RMB.

China's GDP growth rate is still ahead of that of the U.S., the European Union, the UK, and Japan. And that little edge – about 2 percentage points – looks to be able to maintain for at least five more years, albeit gradually getting smaller. China's status as the global trade powerhouse still looks unshakable, as it develops venerable prowess in a few key technologies of the future that are important in driving exports, including solar power, wind power, batteries and electric cars. In the first quarter of this year, China surpassed Japan to be the world's largest exporter of automobiles.

China's trade pattern appears to be undergoing a structural change. Today China's largest trading partner is no longer the U.S., nor the European Union, but the ASEAN market. ASEAN countries are in the process of introducing their own local currency settlement framework, and China's RMB internationalization is part of China's ongoing dialogue with the ASEAN regarding trade settlement.

China's trade with BRICS countries is also increasing rapidly, particularly with respect to Russia in the aftermath of the war in Ukraine. China has signed bilateral local currency settlement agreement or framework with Russia and Brazil. Bilateral trade between China and Russia stood at over US$73 billion in the first four months of this year, surging over 40% year-on-year. For the whole year, total trade could possibly reach close to US$250 billion. Note that over 70% of trade between China and Russia is already settled in RMB and ruble.

Practically China's entire trade with the Global South could eventually be subject to the RMB fold. China certainly takes a cautious, gradual approach to minimize its risk exposure, when it comes to establishing bilateral trade settlement agreements using the RMB. Nevertheless that part of the world represents the most vibrant, the fastest growing economies right now. What does it mean for China, and for the world? It means better opportunities ahead for the RMB.

In short, there is no doubt that the world is starting to embrace currency multipolarity, where several currencies are getting to be increasingly lining up seriously behind the US dollar in global trade, investment, and functioning as the reserve currencies for many countries, with the Chinese RMB being one of the strong contenders. But there is also no doubt that this process will take a long time to work out as shown empirically throughout history.

The odd thing is that the dollar's floundering stature continues to be hijacked by Washington national security politics. For a long time, the foreign policy apparatus in the U.S. has developed an addiction to weaponizing the dollar every time it sees convenient to impose sanctions against a country. This has been done accumulatively upon many countries for the last seventy years, many of which were unilateral actions without the United Nations' authorization. At some point there will be a reckoning.

Currency Multipolarity

And the *Longue Durée*

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French historian Fernand Braudel framed histories, in part, as the interplay of multiple temporalities and their respective rhythms. He considered *événements* as short-term events that punctuate medium term *conjunctures*, and which are set against what he called the *longue durée*. The recent acceleration of de-dollarization - that is, the diminution of the US dollar (USD) in central bank reserve holdings and as a medium of circulation in global trade - and expansion of China's RMB in central bank reserves and use in cross-border settlements can be understood as the confluence of different temporalities and their rhythms.

Today, the world is de-dollarizing faster than over the past 30 years. However, it isn't moving from one state dominated by a single national currency to another state currency. The USD is not giving way to the RMB; the RMB is not trying to "dethrone the dollar." Rather, the transformation is qualitative: a new architecture is emerging, that is more multipolar than has been the case for the past 70 years or so, in which multilateral trade will be settled by a myriad of national currencies, and possibly in due course with a new non-national trade settlement currency. The new "money architecture" is less likely to embody the idea of money as a reserve asset, which underpinned the Bretton Woods settlement. Instead, with an emphasis on enabling intensified cross-border trade, it is likely that a non-national trade settlement currency, as a measure of multilateral clearing of current accounts in the form of a currency unit, will emerge. The new monetary architecture is, therefore, likely to deprive money of the character of a global reserve asset.

The development of digital currencies is an important precondition for the design and implementation of efficient settlements and clearing in conditions of multipolarity. The ability for digital currencies and wallets to support near real-time cross-border transaction settlements was tested in late 2021, and cross-border use of the digital RMB continues to expand as part of the phased test-rollout of China's digital currency. China is at the forefront of the design and development of digital technologies, which will undergird the emergent transnational architecture. But a digital currency is only one half of the equation; money - as a means of payment - is only meaningful in the context of continuous circuits of capital accumulation and transformation, so that exchange must always involve a counterpart. This implies the need to develop a synchronized architecture that can support the capture, storage and dissemination of information about the real economy that can deliver data instantaneously as the counterpart to money flows. Blockchains "with Chinese characteristics" are the technical bedrock for this kind of global digital supply chain architecture.

Unipolar sugar high in context - so, how did we get here?

The USD's reserve status conveyed to the American government "exorbitant privileges." That's how former French President Charles de Gaulle described it in 1965. Indeed, de Gaulle was skeptical that a national currency could be sustained as a neutral medium of exchange and circulation, remarking that it was not possible for the USD to be "an impartial and international trade medium... It is in fact a credit instrument reserved for one state only."

In the 1960s, the U.S. embarked on a series of ambitious national and global initiatives. John F. Kennedy launched a space program in 1961; Lyndon Johnson pursued his Great Society in 1964-1965. Meanwhile, the U.S. had entered an arms race with the USSR and was ensnared in an increasingly expensive ground war in Asia. Ultimately, the Vietnam War was paid for with increased taxes and inflation. Global creditor nations, led by the French, became concerned about the US wherewithal. The French sent a warship to New York harbor in early August 1971 to collect gold from the New York Federal Reserve Bank. Inflation and indebtedness arose as the accumulated consequences of funding war efforts. Richard Nixon suspended the gold peg on August 15, 1971. A deal was cut with OPEC in the latter half of the 1970s, which effectively created the "petro-dollar." Thereafter, trading for OPEC oil would be denominated only in USD. No USD, no oil.

The USSR collapsed in 1991. Thereafter, the US security was never more settled. The world had become unipolar. With the wind in its sails, invested with the zealotry of millenarianism, the U.S. embarked on an intensified program of global military interventions. Between 1989 and 2019, the U.S. initiated on average 3.7 military interventions per year, a rise from the annual average of 2.4 interventions between 1946 and 1989. Between 1990 and 2022, according to Statista, US public debt increased from US$3.2 trillion to US$30.9 trillion. According to Jeffrey Sachs, a good half of this debt is due to the "US government's addition to war and military spending."

History's rhyme, and the perfect storm of de-dollarization

By 2001, the USD's reserve status constituted 73% of foreign reserves of the world's major central banks. At the time, the G7 economies' aggregate GDP (not including the EU) made up about 70% of the global economy in nominal terms. It has been declining ever since.

The 2008 Global Financial Crisis (GFC) exposed fissures in the institutional and structural fabric of U.S.-style finance capital. In the quest for greater and faster yields, financialization had rapidly detached the "exchange value" of fictitious capital circuits from the grounded crystallization of "use value." Financialization led to the expansion of complex webs of fictitious capital, whose modus operandi was wealth accumulation via the motions of liquidity, i.e., exchange value, *in advance of* future production of use value. Fictitious capital comprises claims on future production; it is a necessary part of capital accumulation as it enables the acceleration of production and transformation. The structural problem occurs when the proportions of fictitious capital become incompatible with the real production capacity of economies.

Since the early 1990s, the quantum of value validated in anticipation of future valorization has constantly grown relative to the quantity of wealth actually produced. Inflation had already emerged in the late 2010s across the transatlantic economies due, in large part, to the novel monetary responses to the financial crisis, and was fueled by increased money supply in response to the COVID-19-related slowdown and associated disruptions to supply chains. The disruptions to global energy markets resulting from G7 and EU sanctions against Russian oil and gas exports from early 2022 consolidated the underlying inflationary pressures.

A "perfect storm" of de-dollarization has emerged.

In an effort to tame inflation, in May 2023 the US Federal Reserve increased interest rates to the highest levels in 16 years. Domestic monetary policy imperatives trumped global impact concerns. De Gaulle's skepticism was justified. The USD could not straddle the demands of being a domestic currency and a global reserve. The Triffin Paradox had reared its ugly head. Recent US rate increases are expected to have severe impacts on developing economies, whose debts are denominated in USD, as argued in a recent World Bank Working Paper.

The gradual declining share of USD in central bank reserves over the past three decades reflects to some extent the need to manage these risks, but the composition of reserves has taken a rapid turn away from the USD in the last 12+ months. The increasing weaponization of the dollar and its associated institutions, e.g., SWIFT, has created the conditions in which national central banks will expand their alternative currency hedges. According to data presented by Jen and Freire, the USD's share of global reserves fell during 2022 at 10 times the average rate of the past two decades. When adjusted for inflation, the USD has lost about 11% of its market share since 2016 and twice that since 2008. The aggressive use of sanctions has contributed to de-dollarization; and de-dollarization further undermines the authority of unilateral USD-based sanctions. The "time of peak US sanctions has passed," as Agathe Demarais pithily summarizes in her 2022 book "*Backfire*."

The revenge of the digitalized real economy

Since 2001 when it joined the World Trade Organization, China has become the world's largest trading nation, and the largest trading partner of more than 140 nations. In the 2000s, it grew trade with the mature transatlantic economies of the U.S. and the EU. However, for the past over ten years, China's trade profile has evolved so that ASEAN is now China's largest two-way trading partner, surpassing the EU in 2021. The Belt and Road Initiative (BRI), launched in 2013, has opened the way for expanded trade with many developing nations in the Eurasian continent, extending to the countries of West, East, and Africa. The trade preference index between China and BRI countries has increased approximately 8% faster than has been the case for non-BRI nations leading to recent data suggesting that China's trade value with BRI nations now exceeds that with both the U.S. and the EU.

Real economy value flows underpin the utility of currencies. Money exists as a medium of circulation in complex economies characterized by divisions of labor, by acting as a standard of account. Money balances fill the gap between the sale and purchase of commodities. To support liquidity, China has established a growing network of currency swap arrangements with counterparty central banks, many associated with the BRI. China has expanded its financial architecture into various equities markets, opening up channels for liquidity on the capital accounts side. Cross-border agreements on financial product regulation harmonization, together with access to open RMB trading (Hong Kong and Hainan) provide mechanisms to further improve liquidity.

Trade growth with China, and amongst developing nations themselves, is creating the material conditions necessary to support bilateral trade denominated in national currencies. The RMB's use will no doubt reflect China's role as a major trading nation; but the emerging pattern would for now appear to be one of currency multipolarities rather than the RMB usurping the USD. In due course, a non-national currency for cross-border settlements is on the cards, as mooted by some members of BRICS. Such considerations may draw on the historic lessons of Keynes' 1943 proposal for the bancor, which had enlivened discussions amongst central bankers in China during the late 2010s.

Ultimately, value is anchored in real commodities of use. Functional exchange requires systems that deliver confidence not only in a currency's liquidity, but also in the credibility of the counterpart to the exchange - that is, the products, people and processes themselves, *and the information about those things*. Digitalization of supply chains is the counterpart to the development and use of national digital currencies for cross-border trade. China is a leader in the development of digital currencies. Supply chain data, collected, stored and disseminated across dependable systems free from malfeasance and capricious alterations, makes possible the intensified flow of value across borders. This is what blockchains with Chinese characteristics are, in part, all about. That China has launched the National Blockchain Centre (May 2023), aiming to train 500,000 specialists in blockchain technologies, speaks directly to the centrality of distributed ledgers to the new national and global supply chain architecture.

Currency multipolarity is so much more than the dilution of the USD's footprint. It is about a new architecture of cross-border value flows anchored by data systems in which participating nations and their actors can be confident, and which integrates the expanding physical infrastructure of transportation and logistics, with the digital ecosystems of devices, standards, blockchains, big data computation and automation. Currency multipolarity and digitalization go hand in hand.

There remain many uncertainties as to the precise shape of the evolving institutions of currency multipolarity. However, one thing is certain: the era of the USD as the single global reserve is reaching its end. The *longue durée* of structural evolution continues to unfold.

TIO Spotlight Talk

National Productivity Transformation -- A Key to Global Currency Diversification

An Interview with TI Fellow Zhang Chao

Zhang Chao

Fellow of Taihe Institute
Expert in Macro Economy

TIO As the world undergoes great changes of once-in-a-century nature, what kind of transformation do you see unfolding within international currencies and monetary system, and what are the characteristics?

Zhang For more than a century, the global monetary order experienced dramatic transformations, from the gradual maturation of the gold standard in the 19th century, the formal replacement of the gold standard by the Bretton Woods system after World War II, and, finally, the acceptance of the Jamaica system by the International Monetary Fund in 1976.

Since the implementation of the Jamaica system, countries around the world have officially adopted a floating exchange rate regime that has remained in place to this day. However, as the Jamaica system turned 47 years old, we now witness significant changes in the global monetary landscape. Exchange rates, which have been freely floating, will likely become fixed or at least temporarily fixed. This shift represents a fundamental change in the monetary order and stands as the most notable characteristic of the ongoing transformation of international currencies during this period of once-in-a-century global changes. From the monetary perspective, the intrinsic values of currencies are repositioned in search of a new monetary anchor. And, as reflected in the financial sector, the status of the US dollar as a transaction and reserve currency is being challenged, prompting a resurgence of trade-based currency logic. Meanwhile, sovereign digital currencies are rising in the global financial system. Although these phenomena may appear independent from one another on the surface, they are driven by strong underlying rationales and have been evolving over an extended period.

TIO One of the characteristics you mentioned regarding the "changing landscape" of monetary finance is the uncertain position of the US dollar as the predominant reserve currency. What does this mean for the world economy?

Zhang The transition from the Bretton Woods system, typified by the dollar's tie with gold, to the Jamaica system, which characteristically linked commodities with the dollar, indirectly established a connection between the dollar and other currencies. Recognized by various countries as a secure asset and iconic currency, the dollar emerged as the predominant reserve currency.

Nevertheless, the dollar itself is facing increasing challenges against the backdrop of once-in-a-century global changes. Heightened anxieties revolve around its capacity to procure an adequate quantity of goods and secure them at equitable prices. Non-US currencies are actively seeking alternatives to bypass the dollar in direct trade settlements, indicating a reassessment of the two fundamental aspects of currencies: purchasing power and asset security. We will observe and actively partake in this profound transformation of the monetary system, which will critically influence the world economy.

TIO So, the dollar's decline is a manifestation of America's economic problems and a milestone in the evolving dynamics of Sino-U.S. relations, right?

Zhang It encompasses more than just changes in Sino-U.S. relations. It also carries substantial implications for the global economic landscape. This decline signifies a broader process in which global nations are reassessing the purchasing power and productivity of currencies, and reconstructing the currency value system.

TIO You also mentioned the development of digital currencies. How will digital currencies, as a new form of the global currency in the financial system, impact the world economy?

Zhang Digital currencies are based on the Internet and digital encryption technologies. These currencies emerged through the maturation of relevant hardware and software technologies since the late 1960s and have significant implications for the current monetary system.

Currencies underwent several transformations, from commodities to precious metals and eventually to paper money. We are now witnessing the fourth significant transformation, in which digital currencies, built upon technology and rules, are being integrated into the existing monetary system. Under a new framework, digital currencies will coexist alongside physical currencies to support economic development. I believe this fourth currency revolution will drive the evolution from a singular form of currency, such as physical commodities, precious metals, or paper money, to a new form of sovereign currency composed of precious metals, productivity, and digital currencies. This shift will contribute to the gradual formation of a new global monetary system that leverages the strengths of different currencies. In short, digital currencies are a significant manifestation of once-in-a-century global changes.

TIO What's the logic behind the above-mentioned phenomena? How do these phenomena reflect the broader shift toward a global system of fixed exchange rates?

Zhang Be it a resurgence of physical assets or a renewed interest in precious metals, both indicate skepticism toward dollar assets and exploration of a brand-new currency system. While these phenomena may appear separate, they stem from a shared underlying rationale. These phenomena did not emerge abruptly or coincidentally but resulted from long-term evolution.

First, the rise of digital currencies was triggered by the excessive issuance of credit money. Following the 2008 financial crisis, the US government implemented quantitative easing (QE) as a countermeasure. However, the introduction of QE significantly diluted the dollar's value, arousing concerns among the public. Consequently, the international community began exploring alternative regulated forms of currencies that would not be subject to arbitrary devaluation. Hence, the emergence of digital currencies. Second, the Russia-Ukraine conflict in 2022, against the backdrop of currency over-issuance, highlighted the misuse of the dollar's status as the predominant international reserve currency. This raised doubt about the dollar's ability to safeguard and represent personal wealth. Such events collectively prompted countries to seek freshly minted, universally recognized, and widely circulated currencies that could serve as reliable stores of value in place of the dollar.

As I said, the world is undergoing profound changes. Although the events discussed earlier are noteworthy, they may not be considered definitive. Before a defining event takes place, these changes may appear subtle to individuals who are not actively involved in financial markets or closely monitoring relevant developments.

TIO How should China and other developing countries in the Global South respond to the impacts of these macro changes?

Zhang Before answering this question, let us first address an often-overlooked matter: What is the true essence of a currency beyond its symbolic and numerical representation? Many individuals assume that currency is synonymous with value or wealth. However, if a currency were to lose its ability to facilitate transactions or serve as a reliable store of wealth, people would inevitably question its fundamental nature. For now, I suggest avoiding the use of terms like “de-dollarization wave.” Yet, developing countries have started reassessing the dollar’s status and expressing concerns about its monetary value. These countries are striving to liberate themselves from the constraints imposed by the current dollar-centric monetary system and to reshape the financial order by opting for a wide range of currencies in their trade settlements.

During this process, the clash of currencies brings about a collision of the sovereignty embodied by those currencies. Consequently, currencies turn from an economic matter to a political one. If regional economies are closely interconnected, they tend to consolidate their currencies to facilitate the exchange of goods and ensure stable trade. Over time, large economies with robust growth emerge, and others are able to access a wider array of goods from these economies. In such scenarios, the sovereign currencies of these large economies are regarded as regional settlement currencies. Currently, developing countries are exploring alternative paths as they recognize that what could previously be bought with the dollar may no longer be accessible. The perceived misuse of the dollar’s status has instilled doubt among nations regarding its efficacy in facilitating transactions and retaining value. In their pursuit of new reserve currencies, countries prefer to employ their local currencies. If that option is not viable, they turn to the currencies of nations that can meet their requirements for goods or engage in significant bilateral trade.

TIO You mentioned that countries would choose to adopt the currencies of fast-growing and large economies as a risk mitigation strategy. However, this approach is somewhat passive. In light of this, let us explore how China can play a more active role in the international financial and monetary community.

Zhang The internationalization of the RMB should not be viewed as a specific task with a set endpoint but instead as an outcome that emerges naturally. It is a process that involves development and recognition. The widespread use and acceptance of the RMB are not actively pursued goals but natural consequences of China's economic development, social progress, growing power, and global recognition. To illustrate, we can look at the internationalization of the dollar. The dollar's acceptance as an international reserve currency was not solely due to a deliberate pursuit of internationalization. It was facilitated by various factors, such as the US economy accounting for over 45% of global GDP after World War II, its ability to produce 80% of the allied forces' weaponry, and substantial gold reserves. Therefore, the internationalization of a currency reflects a country's composite national strength. As far as China goes, a steadfast commitment to steady economic development and the augmentation of composite national strength are essential to the internationalization of the RMB.

Apart from fostering economic growth, we need to boost and stabilize our financial market. If our market is robust with controllable risks, high productivity, concentrated industrial clusters, and integrated industry chains, other nations will naturally be inclined to adopt our currency. By further enhancing our financial infrastructure and system to facilitate synchronized development between onshore and offshore markets, we can expedite the internationalization of the RMB.

TIO Thank you. Based on the broad discussions above, could you provide some insights into recent events in the international monetary and financial community? For instance, the Federal Reserve has implemented QE and raised interest rates over the past two years, leading to a growing national debt and inflationary spillover effects. Moreover, Russia was excluded from the U.S.-led SWIFT system, and the dollar assets of the Russian central bank were frozen. Using currencies as a weapon has significantly affected the credibility of the dollar system. Considering the dollar's status as the predominant international reserve currency, what kind of challenges do these events pose to the world? Will the US currency hegemony backfire?

Zhang The challenges confronting the U.S. and the dollar can primarily be attributed to the country's diminishing economic and political stature. Previous solutions employed by the U.S. prove ineffective nowadays. If the U.S. were to strategically loosen its grip and shift its focus toward strengthening its economy and people's livelihood, the position of the dollar would remain relatively stable. However, due to strategic missteps, the U.S. now faces mounting costs to uphold its existing framework. Consequently, it resorted to a series of "dollar weaponization" measures with dual-edged characteristics, as they openly exposed the previously ambiguous "dollar threat" to the world. The U.S. has inadvertently created obstacles for itself.

The trajectory of the US national debt follows a similar pattern. From a macro perspective, accomplishing tasks in the U.S. now comes with higher costs compared with the past, as evidenced by the ever-growing national debt. The cost of achieving an outcome that once required 100 dollars may now entail 1,000 dollars. As time passes, the national debt has snowballed into its current magnitude. From a micro perspective, the distribution of wealth in the U.S. resulted in significant issues. Oligarchies now exert full control over the US economy, tightly intertwined with deep financialization. US politicians and scholars are acutely aware of these challenges but struggle to break free from the current predicament. Overcoming these challenges calls for revolutionary reforms that can disrupt the prevailing patterns of interests and wealth distribution.

If the challenges encountered by the U.S. are not acknowledged and addressed on a global scale, the responsibility for resolving them will ultimately fall upon the U.S. itself. Given the current level of societal productivity, population, and market size, the country cannot bear the weight of such a substantial burden. Once the decline of the U.S. exceeds a certain threshold, the country will unavoidably spiral into a rapid descent.

TIO As you just mentioned, countries worldwide have begun implementing measures to address the consequences arising from the conflict between the declining US national power and its desire to maintain its international standing. We have observed that China and Japan started reducing their US bond holdings a few years ago. ASEAN, BRICS, and other regional organizations have also been implementing measures to promote local currency transactions and reserve currency plans. What significance do you believe these measures and policies have?

Zhang We can approach this issue in three phases.

The first phase involves emergency response. When doubts regarding the credibility of the US dollar arise, major trading nations tend to resort to emergency measures to address immediate trade instability on a case-by-case basis. Regional blocs comprising nations with close trade ties, such as ASEAN and BRICS, have implemented similar policies.

The second phase is characterized by the establishment of new institutional frameworks. The main purpose of these new institutions is to ensure smooth trade operations. Examples include the trade and currency mechanisms within the BRICS countries, as well as bilateral trade systems and currency swap arrangements between China and Brazil and between China and Argentina. While existing currency swap arrangements are typically based on bilateral agreements, there is potential for future development toward more multilateral collaborations. However, the second phase still dwells on trade activities and focuses on the exchange of currencies for transactional purposes only.

In the final phase, major global economies should assume leadership and engage in negotiations to devise a new monetary system. This system should not only support international trade, but also address the imperatives of value preservation. It may involve a single currency or a variety of currencies and may entail the adoption of new methodologies for assessing productivity, the establishment of new rules (such as digital currencies), and the recognition of widely accepted tangible assets as reserves, among other possibilities. The new system should be able to facilitate trade transactions while serving as a robust reservoir of wealth. Only then can it be deemed a truly comprehensive and refined framework.

The reform of the global monetary system is currently in its first phase and partially progressing to the second phase. Therefore, challenges will continue to emerge within the system. While the position of the US dollar may not experience an immediate drastic decline, fluctuations are to be expected. However, with its influence gradually waning, the long-term trajectory of the US dollar will remain unchanged.

TIO Your analysis just answered a broader question: how close are we to witnessing a new global currency order? It seems that there is still a long way to go, which underscores the need for further development and progress.

Zhang Indeed. The establishment of a new order would definitely be triggered by unexpected events, which will drive a shared recognition and acceptance of new rules and frameworks. It is at that moment that we can confidently assert the presence of necessary conditions for establishing a new and universally applicable monetary system.

TIO Thank you. You just offered a glimpse into the future. However, if we reflect on the past, the notions of “de-dollarization” and the prediction of US dollar collapsing emerged as early as four to five decades ago. The concept of the BRICS reserve currency R5 is not a recent development either. What could have prompted nations to resurrect these discussions and implement corresponding policies?

Zhang Currency is the bedrock of finance. That’s why people raised this question earlier. However, discussions around currency at that time often confined themselves to a financial perspective, overlooking the essential factor that a currency represents—productivity. When concerns were raised about a potential collapse of the US dollar several decades ago, the productivity that backed this currency was robust. The U.S. was holding an irreplaceable position within the global economic system. Given the robust productivity, a sudden collapse of the dollar was highly unlikely. The “theory of a dollar collapse” failed to acknowledge this at that time. It was premature, I think.

Since the financial crisis, there has been a heightened focus on financial and trade issues. In my view, the most crucial concern lies in the development of the U.S. In educational scenarios, we often analyze a currency through the lens of purchasing power. Yet, upon closer examination, we may encounter the notion of productivity. Purchasing raw materials is a part of the production process, and purchasing consumer goods constitutes the last step of the production cycle. The notion of purchasing power is straightforward and easy to comprehend. For instance, one can directly compare the amount of rice that can be obtained with one US dollar versus one Chinese yuan. However, the concept of productivity encompasses broader dimensions. For example, having a stable financial system may well justify productivity. Additionally, when we possess tangible assets that have a fair value, we can easily procure raw materials and consequently enhance productivity. The combined productivity ultimately determines the value and worth of the currency. Consensus on these issues signals the dawn of a new global monetary system.

TIO Your viewpoint holds great importance. Productivity is indeed a factor that has not received adequate attention. To conclude this interview, let’s redirect our attention to the subject of the internationalization of the RMB. How would you assess the current internationalization progress? From what perspective should we approach the understanding of the internationalization of the RMB?

Zhang The underlying logic of the internationalization of the RMB is complex, but we can pinpoint some milestones as key markers for analysis. The internationalization process of a currency typically unfolds in three stages.

The first stage features the early phase of monetary regionalization. The process of monetary regionalization is often accompanied by a significant increase in goods trading and the setup of necessary financial infrastructure within the region.

The next stage is the broad use of the currency in international trade. This means the global clearing and settlement mechanisms of the currency, as well as its financial infrastructure, are in place. Moreover, the currency exhibits robust purchasing power and receives widespread recognition, making it the primary currency used in global trade.

The final stage is when the currency is recognized for its value and becomes a reserve currency. The value of a currency reflects a nation's overall strength. When the global community uses the currency not only in trade, but also as a reserve currency, we can conclude that the internationalization of the currency is essentially accomplished.

At present, the internationalization of the RMB is approaching the end of its initial stage and is poised to swiftly advance to the next stage. The momentum behind this progress is promising.

This interview was conducted by Liang Zinan,
International Communications Officer of Taihe Institute.

Youth

Voices

De-Dollarization Proposals and the Yuan: The Dawn of a Multipolar Currency World?

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The dominance of the US dollar, which has held its position as the world's most powerful currency since the end of World War II, faces looming challenges. While the dollar is experiencing rapid appreciation and countries are grappling with currency depreciation, capital outflow, and inflation, economists globally are recognizing the need to address the rising dollar risks.

An increasing number of nations have expressed their readiness for a multipolar currency world, reduced their holdings of US Treasury bonds, and explored alternative measures such as bilateral currency swap agreements. Moreover, central banks have been purchasing gold at the fastest pace never seen since 1967, highlighting a concerted effort to diversify their reserves away from the US dollar.

As such, this article delves into the voices advocating for de-dollarization, while also examining the potential role of the Chinese yuan in the transformative process. Additionally, the article explores the implications of a multipolar currency world for China and the global economy, with a particular emphasis on the growing interest for local currency settlement in trade transactions involving the Asian giant.

Brazil's growing affinity for the yuan and de-dollarization

The US dollar has enjoyed a dominant position in global finance for decades and continues to be the most widely used currency in the forex market, representing approximately 88% of all transactions. In terms of international payments, the US dollar is involved in around 42% of transactions, followed by the euro at approximately 32%. Nevertheless, there has been a shift towards multipolar currencies, with Latin American countries such as Brazil and Argentina expressing increasing interest in diversifying away from the US dollar.

Indeed, during his mid-April 2023 visit to China, Brazilian President Lula da Silva questioned the use of the US dollar as the global trade reference currency. In fact, Brazil intends to significantly increase the use of the yuan in its commercial transactions with China. According to the latest report published by the Central Bank of Brazil, by the end of 2022, the Chinese yuan accounted for 5.37% of Brazil's international exchange reserves. This surpasses the proportion held in euros, which stood at 4.74%, making the yuan the second-largest reserve currency for the country. This strategic move aims to reduce Brazil's exposure to the risks associated with the appreciation of the US dollar and enhance its economic ties with China.

Also, Brazil and Argentina recently announced their intention to launch a common synthetic currency for their bilateral trade and financial flows as an alternative to the US dollar. While many economists have met these initiatives with skepticism and considered it unlikely in the short or medium term, deeper South America integration has, as one of its tenets, the aim of de-dollarization.

Russia's departure from the hegemony of the US dollar

Recent geopolitical events have also challenged the perception of the US dollar's stability and reliability. The Ukraine crisis triggered economic sanctions that led to the freezing of Russia's reserves in international banks. The sanctions resulted in approximately US$300 billion being blocked, disrupting Russia's financial operations, and highlighting the risks of over reliance on the US dollar.

Consequently, Russia and China deepened financial systems cooperation, reaching an 80-time increase of ruble-yuan trade in eight months. According to a recent study conducted by the Russian bank Promsvyazbank, the Chinese yuan surpassed the euro last year in terms of foreign exchange settlements for Russian small and medium-sized enterprises. The study, which involved over 1,700 Russian business entrepreneurs, revealed that 31% of transactions were conducted using the Chinese yuan, while the euro accounted for 28% of the transactions. This shift in preference can be attributed to the European Union's imposition of sanctions on Russia, which resulted in the freezing of Russian euro-denominated assets and the exclusion of Russia from the SWIFT banking network.

Moreover, the increasing popularity of the Chinese yuan among exporters highlights the growing trend of Russian businesses redirecting their focus towards new markets, particularly China. Furthermore, the central banks of Iran and Russia are reported to be working together and launching a cryptocurrency backed in gold. If true, the strategy may help evasion of US sanctions while taking advantage of the anonymity of cryptocurrency transactions.

China's efforts to internationalize the yuan

The internationalization of the yuan continues to face significant limitations, such as the dilemma of financing the Belt and Road Initiative projects. Investing with US dollars necessitates an extensive capital account and exchange rate management, both of which hamper yuan internationalization. Concurrently, promoting internationalization for BRI investment requires a more liberalized approach to both the capital account and exchange rate regime. Even though this implicates the interplay between currency internationalization and project financing, China has been actively promoting the internationalization of its currency. It has signed bilateral local currency settlement agreements with numerous countries, including Brazil, Laos, and Indonesia. In addition, over 70% of trade between China and Russia is settled in yuan and the ruble. This growing trend demonstrates China's commitment to reducing its reliance on the US dollar and establishing yuan prominence in global trade.

Moreover, China has been making significant progress in expanding the use of the yuan in cross-border trade settlement. By the end of 2022, the yuan's share in global trade settlement had significantly increased over past years. This upward trend indicates confidence and a growing acceptance for the yuan as an alternative to the US dollar for international transactions. The growing prominence of China in the global economy has also given rise to increased academic discussion concerning the role of the yuan in the international monetary system. Both the post-pandemic era and aftermath of the Ukraine crisis have the potential to spur profound reform of the international monetary system. Thus, the Chinese currency is expected to benefit from an enhanced global standing alongside the US dollar and the euro.

Challenges of shifting away from the US dollar

While countries express interest in diversifying away from the US dollar, there are important challenges and considerations to address. The stability and widespread acceptance of the US dollar make it a preferred choice for international transactions. Furthermore, the US dollar's role as the primary reserve currency remains significant, accounting for approximately 58.36% of global reserves. In comparison, the yuan represents only around 2.69% of global reserves. To challenge the US dollar's dominance, countries seeking an alternative benchmark must address several key factors. First, they need to ensure the stability and reliability of the chosen currency. The US dollar's longstanding track record in these areas has instilled confidence among investors and market participants. Additionally, any alternative currency must possess deep and liquid markets, allowing for seamless transactions and widespread accessibility. Furthermore, the transition to a multipolar currency system requires cooperation and consensus of multiple countries. While countries like Brazil and China, among others, have taken steps towards promoting the use of their currencies in bilateral trade, achieving a truly multipolar system necessitates broader international support and coordination. Movement in this direction include discussions between the UAE (United Arab Emirates) and India to explore the usage of rupees for non-oil commodities trade, the potential establishment of regional mechanisms, such as the revival of the decades-old proposal of the "Asian Monetary Fund" by Malaysian PM Anwar Ibrahim, and the local currency settlement frameworks adopted by ASEAN countries, all of which serve as building blocks towards a more diversified global currency landscape.

Implications for China and the world

The internationalization of the yuan presents a range of opportunities and challenges for China, with implications for its economic and geopolitical objectives. In terms of trade settlement, the internationalization of the Chinese yuan enables foreign companies engaging in business with mainland Chinese counterparts to transact and settle trade in yuan. This not only reduces foreign exchange costs, but also provides access to larger markets and secures better trade terms.

Additionally, the development of offshore yuan bond markets may facilitate financing and borrowing, offering borrowers competitive and diversified funding sources while creating opportunities for international and retail investors.

Furthermore, in terms of capital management, companies operating in free trade zones may directly borrow and lend funds with overseas entities through yuan cash pooling. This empowers multinational companies to centrally manage their funds and conduct global transactions directly with the yuan. As the world's second-largest economy, China seeks to bolster its influence and reduce vulnerability to external shocks by expanding the global role of its currency.

The increasing acceptance of the yuan in trade settlements not only strengthens China's economic position but also aligns with its broader geopolitical ambitions. By promoting the use of the yuan in international transactions, China can diversify its foreign exchange reserves and reduce its dependence on the fluctuations of the US dollar. This diversification mitigates risks associated with a single dominant currency and enhances China's resilience to external shocks.

Furthermore, the internationalization of the yuan allows China to exert greater influence in global financial governance and to shape the rules and standards of the international monetary system. The emergence of a multipolar currency system, with the yuan playing a significant role alongside the US dollar and the euro, contributes to a more balanced and resilient international monetary framework. The shift reduces potential risks associated with the dominance of a single currency and promotes stability in the global financial system. It also provides countries with more options for conducting trade and managing their foreign exchange reserves and fosters economic cooperation and financial inclusion. Therefore, the internationalization of the yuan offers China opportunities to enhance its economic influence, reduce vulnerability, and shape global financial governance. Simultaneously, it contributes to the development of a more balanced and resilient international monetary system, providing countries with greater stability, options, and opportunities for cooperation.

Conclusion and reflections

While the US dollar's global hegemony currently remains unchallenged, the rise of interest rates, the impact of geopolitical events, and the efforts of countries like China to promote alternative currencies are driving discussions about currency multi-polarization in the future. Latin American countries, including Brazil, have shown increasing interest in diversifying away from the US dollar and strengthening their economic ties with China. However, the transition to a multipolar currency system is a complex and gradual process requiring significant coordination among nations and the establishment of robust mechanisms. The role of the yuan in this process is crucial. China's efforts to internationalize its currency through trade agreements and the expansion of the yuan's use in cross-border settlements demonstrate its commitment to reducing reliance on the US dollar. While challenges and obstacles exist, some key countries are already embracing currency multipolarity and its potential to reshape global finance and foster a more balanced and resilient international monetary system.

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