Signs of the US dollar’s demise

John Chan
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An article by veteran Middle East journalist Robert Fisk in the British *Independent* on October 6, entitled “The demise of the dollar”, is credited with adding to the recent weakness of the US dollar and the rise of gold prices.

The exclusive report revealed that finance ministers and central bankers from the Gulf States, China, Russia, Japan and France had held a series of secret meetings to plan an end to the use of the US dollar for oil trading by 2018. The replacement would be a basket of currencies, including the euro, the Japanese yen, the Chinese yuan, gold and possibly a new currency issued by the Gulf Cooperation Council.

If true, such a move would be an economic and political bombshell. An end to the use of the US dollar for trading in such a vital commodity as oil would be a further blow to its pivotal role since the end of World War II as the world’s reserve currency. With no obvious solid replacement, the demise of the dollar would be a recipe for the emergence of antagonistic currency and trade blocs. For the US, it would end its ability to readily fund its huge debts by selling bonds denominated in the world’s reserve currency.

An unnamed Chinese banker told the *Independent* that the plans to remove the dollar from the Middle East oil trade would fundamentally change the face of international financial transactions. The meetings were clearly highly sensitive, as they involved a number of close US allies—Japan, Saudi Arabia and the Gulf States—and all parties would be concerned about Washington’s reaction.

As the same Chinese banker explained: “America and Britain must be very worried. You will know how worried by the thunder of denials this news will generate.” Indeed, Saudi Arabia and other Gulf oil producers, as well as Japan and Russia, denied any such meetings had taken place. Fisk did not, however, resile from his report, writing on October 7 that Saudi denials were simply regarded “as a normal part of Gulf politics”.

The reaction of the markets indicated that the story was not implausible. In fact, there has been a growing discussion in financial circles about replacing the US dollar. Financial turbulence and the massive growth of US government debt that stands at nearly $US12 trillion as a result of falling tax revenues and astronomical bailouts to Wall Street, has created considerable nervousness about the dollar, particularly among governments holding huge dollar reserves.

The Gulf Cooperation Council of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates holds over $2 trillion in dollar reserves. China has currency reserves of more than $2.27 trillion, mostly in US dollars. A long-term decline in the value of the dollar would result in huge losses for these countries. At the same time, any rapid withdrawal from the dollar threatens to trigger a panic that would magnify losses by sending its value plunging even lower.

As the *Independent* pointed out, China has been the “most enthusiastic” power pushing for an alternative to the dollar for oil trading. It not only imports huge amounts of oil from the Middle East, but is also a growing exporter of manufactured goods and an increasingly large investor in the region.

Beijing is well aware of the dangers involved in a protracted decline in the dollar. Not only would an ongoing slide affect the value of its dollar-denominated assets, but would impact on Chinese exports to the US. China’s purchases of US bonds have been aimed at maintaining the existing exchange rates between the dollar and the yuan, which underpin China’s huge export trade to the US.

At the same time, China has begun to explore alternatives. Beijing has signed currency swap agreements with Russia and a number of Asian and Latin American countries to settle trade in their own currencies, rather than the US dollar. Brazil has discussed similar agreement with China. Moreover, Beijing is increasingly using its currency reserves to buy overseas minerals and industrial assets, rather than to purchase US Treasury bills.

In March, Zhou Xiaochuan, head of the Chinese central bank, published an essay calling for the replacement of the US dollar with International Monetary Fund (IMF) Special Drawing Rights—in effect a basket of currencies. During his trip to China in June, US Treasury Secretary Timothy Geithner assured Beijing that the Obama administration would make the necessary savage cuts of social spending and the living standards of the American working class to rein in US debt and maintain the dollar’s stability.

Former Chinese central bank adviser Yu Yongding told *Bloomberg News* before he met Geithner: “I wish to tell the US government: ‘Don’t be complacent and think there isn’t any alternative for China to buy your bills and bonds'. The euro is an alternative. And there are lots of raw materials we can still buy."

Writing on October 13, *Financial Times* commentator Martin Wolf played down talk of the "dollar's death" as exaggerated. "Unless and until China removes exchange controls and develops deep and liquid financial markets—probably a generation away—the euro is the dollar's only serious competitor. At present, 65 percent of the world's reserves are in dollars and 25 percent in euros. Yes, there could be some shift. But it is likely to be slow. The euro zone also has high fiscal deficits and debts. The dollar will exist 30 years from now; the euro's fate is less certain," he explained.

In fact, the lack of any alternative to the dollar as the global reserve currency does not preclude its "demise". It simply means that the consequence would be the formation of rival currency blocs and a descent into currency and trade conflicts.

Others, like World Bank head Robert Zoellick, recognise the dangers. In a speech in late September, Zoellick warned: "The United States would be mistaken to take for granted the dollar's place as the world's predominant reserve currency. Looking forward there will be increasingly other options to the dollar." He added: "One of the legacies of this crisis may be a recognition of changed economic power relations."

The dominant role of the dollar was bound up with the overwhelming industrial predominance of the US following World War II. Washington effectively dictated the terms of the post-war global economic order encapsulated in the Bretton Woods agreement under which the US dollar, backed by a fixed exchange rate with gold, functioned as the world's reserve currency.

As Japan and Europe recovered, however, the relative decline of the US was expressed in the decision by US President Nixon to end the gold backing for the dollar in 1971. The turn to the exploitation of cheap labour through globalised production in the 1980s and 1990s led to a hollowing out of US industry and the vast financialisation of the American economy. Those processes accelerated after the collapse of the Soviet Union and the opening up of China and India as vast reservoirs of low-paid labour, and ultimately led to last year's catastrophic financial meltdown centred on Wall Street.

According to the *Independent*, the US was aware of the meetings over dollar oil trading and "sure to fight this international cabal". The article cited Beijing's former special envoy to the Middle East, Sun Bigan, who wrote in an official journal that "bilateral quarrels and clashes [with the US] are unavoidable" over the energy interests in the Middle East. "This sounds like a dangerous prediction of a future economic war between US and China over Middle East oil—yet again turning the region's conflicts into a battle for great power supremacy," the *Independent* commented.

Competition over energy supplies lies behind the present US-led confrontation with Iran. Using Iran's nuclear programs as the pretext, Washington has been pushing for harsh new sanctions against Tehran that would impact on its oil and gas trade. China, which is one of Iran's largest trading partners and importer of Iranian energy, has resisted a new round of sanctions.

At the meeting of the Shanghai Cooperation Organisation (SCO) in Beijing last week, Iran, which is a SCO observer state, backed the creation of a new unified regional currency, an idea proposed by Russia. The SCO was formed by Russia, China and several Central Asian republics in 2001 to counter the US influence in the region. Iran replaced the dollar with the euro and yen as its trading currencies three years ago, due to intensifying US-led pressure.

Competition over raw materials is also taking place in Africa. In Ghana, the Chinese state oil company CNOOC is competing with the US Exxon Mobil's $4 billion bid for Jubilee, one of the largest oilfields in Africa. China International Fund and oil giant Sinopec are setting up a $7 billion Guinea Development Corporation to build infrastructure, mining and energy projects for the Guinea regime, which is facing Western sanctions. The fund is more than twice the size of Guinea's entire GDP. Guinea has the world's biggest reserve of bauxite, as well as large quantities of gold, diamond, uranium, iron ore and potentially oil.

A recent Lex column in the *Financial Times* linked Sino-US competition for African oil to the weak dollar. Referring to the size of the Chinese bids, the article noted: "The more China's leaders perceive their pile of greenbacks to be a wasting asset the more it makes sense to pledge or spend them today. Overpaying is in the eye of the beholder if such dollar anxieties are vindicated." In other words, China is translating at least some of its dollar reserves into energy and mineral assets, contributing to the weakening of the US dollar.

In this context, high-level meetings about the long-term replacement of the dollar in Middle East oil trading may well have taken place, despite the subsequent denials, pointing to deepening tensions and rivalry between the major powers, particularly over vital energy supplies.