European Central Bank chief warns of global fragmentation

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The president of the European Central Bank, Christine Lagarde, has joined a growing chorus of voices warning that the fragmentation of the world economy could have significant effects on the international financial system and economic growth as well as promoting inflation.

The deepening rifts have been set in motion by the US-led NATO war against Russia in Ukraine and the stepped-up confrontation of the US against China.

In a speech at a Council on Foreign Relations event in New York on Monday, Lagarde said the tectonic plates of geopolitics were "shifting faster."

"We are witnessing a fragmentation of the global economy into competing blocs, with each bloc trying to pull as much of the rest of the world closer to its respective strategic interests and shared values. And this fragmentation may well coalesce around two blocs led respectively by the two largest economies in the world."

This could have "profound effects" in the policy environment for central banks and we "may see more instability as global supply elasticity wanes and… we could see more multipolarity as geopolitical tensions continue to mount."

The period of relative stability following the end of the Cold War was now giving way to one of lasting instability resulting in "lower growth, higher costs and more uncertain trade partnerships" which could lead to the risk of repeated supply shocks.

The most visible shocks so far had been the European energy crisis, but other critical supplies could be affected as well. She noted that the US was completely dependent on imports for at least 14 critical minerals and Europe depended on China for 98 percent of its supply of rare earth elements, which are vital for key areas of the economy.

"If global value chains fragment along geopolitical lines, the increase in the global level of consumer prices could range between around 5 percent in the short run and roughly 1 percent in the long run," she said.

In the period of US dominance after 1945, *Pax Americana*, the dollar became ensconced as the global reserve and transactions currency, with the euro, in the more recent period, rising to second place, but new trade patterns had ramifications for the international payments system.

"In recent decades," she said, "China has already increased 130-fold its bilateral trade in goods with emerging markets and developing economies, with the country becoming the world's top exporter."

There was a significant correlation between a country's trade with China and its willingness to hold its currency, the renminbi, as a reserve.

This could lead to certain countries seeking to lessen their dependence on the Western payments system for reasons of political preference, financial dependence, or the use of sanctions. According to the International Monetary Fund, the number of countries under sanctions, virtually all of them stemming from actions by the US, doubled from 2012 to 2022.

Such developments, she said, did not point to any imminent loss of dominance for the dollar and the euro "but they do suggest that international currency status should no longer be taken for granted.

In preparing her remarks, Lagarde would undoubtedly have taken note of the speech by Brazilian President Lula during a visit to China a few days before.

In what was described as an "impassioned speech" at a meeting organised by the New Development Bank in Shanghai, he called on developing countries to move away from the dollar in their international trade relations.

The New Development Bank is known as the bank of the BRICS grouping which, in addition to Brazil and China, comprises Russia, India and South Africa.

To loud applause from the audience of Chinese and Brazilian officials, he said: "Every night I ask myself why all countries have to base their trade on the dollar? Why can't we do trade based on our own currencies? Who was it that decided that the dollar was the currency after the disappearance of the gold standard?"

Brazil's trade with China has expanded rapidly over the past decade, now totaling more than $150 billion, and there are moves to base this trade in their own currencies, with the first of such agreements being made in recent weeks.

Warming to his subject, Lula continued: “Why can’t a bank like that of the BRICS have a currency to finance trade relations between Brazil and China, between Brazil and other countries? It’s difficult because we are unaccustomed [to the idea]. Everyone depends on just one currency.”

The issue is not just one of thinking, however, because as the *Financial Times* pointed out commodity markets are based on the dollar and mineral companies, such as the iron ore giant Vale, keep most of their transactions dollar denominated.

However, notwithstanding these existing relations, there is clearly a push to weaken, if not break, the enormous power which is provided to the US because of dollar dominance.

The weakening US position was the subject of comments by former Democrat US treasury secretary Lawrence Summers on Bloomberg Television who said it was “troubling” that it was losing influence.

“There’s a growing acceptance of fragmentation, and—maybe even more troubling—I think there’s a growing sense that ours may not be the best fragment to be associated with.”

Summers was speaking from the sidelines of the IMF-World Bank meetings in Washington last week where fragmentation was one of the major issues under discussion.

“Somebody from a developing country said to me, ‘what we get from China is an airport. What we get from the United States is a lecture,’” he said.

Summers said the recently brokered deal by China for a rapprochement between Saudi Arabia and Iran was a “huge challenge for the United States.”

Always the firmest defender of US imperialism both on the political and financial fronts, he continued: “We are on the right side of history—with our commitment to democracy, with our resistance to aggression in Russia. But it’s looking a bit lonely on the right side of history, as those who seem much less on the right side of history are increasingly banding together in a whole range of structures.”

In an allusion to the role of the dollar and the threats to its global dominance, he said: “If the Bretton Woods system is not delivering strongly enough around the world, there are going to be serious challenges and proposed alternatives.”

Trade and finance are not the only issues. The use by the US of dollar supremacy to enforce its geopolitical objectives is giving rise to opposition, especially following the decision to freeze the dollar holdings of the Russian central bank at the start of the Ukraine war.

As *Financial Times* foreign affairs columnist Gideon Rachman noted in a comment on Tuesday: “The US dollar, which has gained international credibility as a ‘safe haven’ currency, now looks less safe to those who fear they might one day be on the wrong side of a geopolitical dispute with Washington.”

The mounting opposition to dollar hegemony will undoubtedly be the subject of discussion in Washington. While there is little prospect of its immediate replacement as the global currency, US imperialism has no intention of allowing its power to be whittled away.

It should be recalled that in 1971 the weakening position of the US in global markets led to the decision by President Nixon to unilaterally end the Bretton Woods agreement of 1944 by removing the gold backing from the US currency. The so-called partners and allies of the US found out about the decision, like everyone else, when Nixon announced it in a Sunday night television broadcast.

The dollar maintained its global role after the Nixon decision because the US still retained considerable economic power. But in the more than half a century since then, that power has been significantly eroded, and the US financial system has become the source of major crises for the world economy and its financial system.

Faced with economic decline, US imperialism is seeking to maintain its hegemony, of which dollar dominance is a key component, by military means, underscoring the importance of the April 30 May Day commemoration organised by the International Committee of the Fourth International to develop the international struggle of the working class against war on the basis of a socialist program.