Article

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De-Dollarization: Does Decreased Dependence on the Dollar Affect its Hegemony?

There is a growing discussion about whether a shift towards the use of currencies other than the dollar in certain trade deals will lead to a process of de-dollarization, and whether this will result in the reduction of the dollar's hegemony in the current world order.

This is not the first time that people have speculated about the possibility of the dollar's demise, and with the continuous fluctuations within the economy, it won't be the last time. But to understand the current discussion, and put it into perspective, we need to look at the reality of the system- both the political and economic aspects of it- and understand how the USA has embedded itself within the Capitalist World Order that all the countries have given their allegiance to.

Why has this discussion re-started?

Recent news reports show states that have taken steps to negotiate deals in the Chinese Yuan, instead of the US Dollar, consequently reducing their dependence on the dollar.

- The central bank of Iraq, a major oil supplier, announced that it would allow trade with China to be settled in Yuan for the first time.
- Bangladesh's Central Bank made a similar announcement in September.
- Members of the China-dominated Shanghai Cooperation Organisation agreed to increase trade in their local currencies. Apart from China, the bloc consists of Russia, India, Pakistan, Uzbekistan, Kazakhstan, Tajikistan and Kyrgyzstan.
- In December, China and Saudi Arabia carried out their first transaction in Yuan.
- Russia has decided to store all its oil and gas surplus revenue in 2023 in Yuan as it increasingly turns to the Chinese currency for its forex reserves. (Source: Al Jazeera)
- Brazil and China reached a deal to trade using their own currencies rather than the US dollar. The Chinese are fulfilling their vow from February to open up a clearing house to settle Yuan-denominated trades in Brazil, having previously announced similar clearing houses in Pakistan, Kazakhstan, and Laos. (Source)
- China has been getting rid of its US Treasury bonds, which are among the tools countries use to keep dollar reserves. It now holds $870bn in US debt, the lowest amount since 2010. It has also been negotiating deals with other countries to trade in the Yuan. (CFR)
- Both China and Russia are transacting oil in their local currencies.
- The EU has made arrangements to settle Iranian oil trades in euros.
- India has agreed a deal to pay for Iranian oil in rupees.

These decisions have been motivated by various political realities: from the USA's decision to impose financial sanctions on Russia, to a desire to purchase oil from Iran and avoid the political tensions surrounding the Nuclear Deal.

From a strategic point of view, the effort to reduce their reliance on the dollar is a result of a fear that the US could use the power of the dollar to target other countries, as they did when they sanctioned Russia. By reducing their reliance on the dollar, and moving their trade to another currency like the yuan, the states could potentially undermine the dollar's soft power.

From an economic point of view, a reduction in their reliance on the dollar may allow them to maintain their economy and reduce the impact that the USA economic policies will have on them.

This is important because as the dollar power increases, it amplifies inflationary pressures on other countries. That makes it difficult for central banks to tame high inflation. The pain increases as the dollar's strength causes a squeeze on trade volumes, tighter trade financing conditions and burgeoning sovereign debts alongside surging debt-servicing costs. Then there is the fact that, as the dollar gains strength, it becomes a drag on global economic activity, pressuring other currencies to weaken and fueling even higher dollar strength. This outcome further weighs on economic activity, reinforcing currency weakness, setting in motion a self-reinforcing feedback doom loop. One negative outcome triggers another. (Source)

So, diversifying could help them to weather the effects of the dollar, and that would depend on numerous other factors.

But this diversification mean that the Dollar will completely lose its dominance?

No, it doesn't. Because the dollar is still dominant- the rise in use of other currencies hasn't caused much of a dent in their dominance.

"Strikingly, the decline in the dollar's share has not been accompanied by an increase in the shares of the pound sterling, yen and euro, other long-standing reserve currencies…. Rather, the shift out of dollars has been in two directions: a quarter into the Chinese renminbi, and three quarters into the currencies of smaller countries that have played a more limited role as reserve currencies." (Source)

"It may usher in the beginning of a more fractured system that *could ultimately blunt the U.S.'s ability to use financial sanctions as a weapon… "The more countries you force to find those alternatives, effectively what you're going to do is increase economies of scale and experience in those areas."* (WSJ)

But while the central banks are holding less dollars as reserves (when compared to the last year), the IMF notes that the dollar still plays "an outsized role" in global markets due to its dominant role in global trade, international debt and non-bank borrowing, which still far outstrips the US' share of trade, bond issuance, and international borrowing and lending. (Source)

"Factors that contribute to the dollar's dominance include its stable value, the size of the U.S. economy, and the United States' geopolitical heft. In addition, no other country has a market for its debt akin to the United States', which totals roughly $18 trillion. "It's more helpful to think of U.S. Treasuries as the world's leading reserve asset. It's hard to compete with the dollar if you don't have a market analogous to the Treasury market." (CFR)

Despite the slip in the share of foreign exchange reserves, the dollar still accounts for more than all other currencies combined. The yuan only accounts for 2.7% of global foreign-currency reserves. (WSJ)

Understanding the depth of the situation is essential

It's true that countries are trying to diversify; this is an inevitable reality of the current system where countries are constantly pitted against each other while trying to exercise their national interest. But in order to understand the situation, we can't just look at the economic statistics, or even at individual political events. To gain a deeper understanding of the situation, we need to understand how the system functions and the role the dollar plays within it.

If the situation is evaluated purely as a zero sum game, with states that have differing agendas are competing with each other, it seems as if the steps that China and other states are taking will lead to dependence from the US and the dollar. But when the situation is understood for an ideological point of view, with states that pursue their own interests within a certain perimeter, to ensure that the Capitalist ideology continues to dominate, the analysis of the situation changes a bit; especially when we look at how the USA embedded the dollar into the system that emanated from the Capitalist ideology.

The Dollars Hegemonic Status

In 1971, President Nixon took the dollar off gold. Since then, critical commodities, the most notable being oil, are denominated in fiat dollars, rather than being backed by gold or silver. The US strengthened the position of the dollar, when it extracted an agreement from oil producing countries like Saudi, to only sell oil in dollars creating what's known as 'petro dollars'. So the rest of the world accepted the dollar, as they needed dollars to buy oil.

This affects trade, as exporting nations compete in global market to capture needed dollars to service dollar-denominated foreign capital and debt, to pay for imported energy, raw material and capital goods, to pay intellectual property fees and information technology fees.

And by pegging other currencies to the dollar, the dollar separates the trade value of every currency from direct connection to the productivity of the issuing economy to link it directly to the size of dollar reserves held by the issuing central bank.

As a result, the dollar hegemony enables the US to indirectly own the entire global economy by requiring its wealth to be denominated in fiat dollars that the US can print at will with little monetary penalties.

The Dollar is just one piece of the System, in which the USA is the Global Hegemon

In the mid 1900's, when the previous imperialist era was coming to an end as the World Wars wreaked havoc across the world, the USA emerged as the dominant hegemon bringing with it a new World Order that followed the Capitalist ideology and made certain that the rest of the world gave their allegiance to it.

They introduced a number of measures including a desire to repair the world economy by allowing for the dominance of the dollar, as other countries pegged their local currencies to it and held dollars in their reserves to maintain their exchange rates. The dollar became deeply entrenched into the system, and the US's deep and flexible financial market, comparatively transparent corporate governance norms and the dollar's stability ensured that the currency has remained dominant. (Source)

But this goes far beyond the dollar as a currency that's used between states, and this is where the political and economic realms are interlinked.

When the USA emerged as the dominant power in the post-World War era, they used their economic strength to recreate the World order; establishing international organizations, embedding the dollar into the system, setting up various alliances, and ensuring that it was in the interest of the states to work within their version of the Capitalist System. When the USA set up this World Order, it did it with the support of the other powerful nations, all of whom agreed to reduce part of their state's sovereignty to the International System in return for the benefit that they would gain by working within the System in accordance to the rules set by the USA.

As a result, even while the states are stuck in a zero sum game, they are embedded into the system in which the USA is dominant- and to remove the USA, means they would need to have a state which could replace it within the current World Order- which is not going to happen any time soon. This is because the other states do not have the same power or legitimacy that the USA currently holds, both of which would be needed for a new hegemon to be accepted in place of the USA. And that means that the Dollar will remain as the dominant currency, even if the states try to reduce their reliance on it. This is especially true when you consider the fact that every currency- including China's yuan- is tied to the dollar.

China is not a contender for the position of Global Hegemon – so their currency will not replace the Dollar Hegemony

"The only currency that can replace the US dollar in the long run is the renminbi, but for it to ever take up that role, the currency has to be fully convertible... A currency becomes fully convertible when it can be exchanged freely into other currencies for all purposes – in financial markets, trade or on global foreign exchange markets. However, the yuan is convertible only for limited purposes, such as trade, restricting its allure despite the ever-increasing impact of China on the global economy. (Source: Al Jazeera)

But currency issues aside, China's long term objective isn't the destruction of the USA- it's to increase their independence in the World Order that the USA created, so that they are able to exercise their national interest without USA's interference. The two countries are working in the same system, and the economy has made them interdependent.

This is why a Complete Rejection of the Current System – and its Currency- is essential

The discussion of the De-dollarisation issue makes one thing very clear – there is a very important reason why we will reject the current currencies when the Khilafah is re-established inshAllah.

Being a part of this economic system, and accepting the current fiat currencies makes us entirely dependent on enemy states like the USA. Through the Dollar, they are able to ensure that our economy is dependent on them and this allows the USA to dictate our policies (both directly and indirectly) and ensure that we remain subservient to them.

We are not allowed to be subservient or dependent to foreign states in Islam. This is especially true when it comes to enemy states like the USA, Russia, China, Britain and France, who would want to dominant or destroy the Khilafah. We must take precautions against them, which would not be possible if we are interdependent.

There is no doubt that using the fiat currencies that exist today would make us dependent on these states.

As such, under the Khilafah, we will have our own independent currency, and it is not permitted for it to be linked to any foreign currency.

"To create a specific currency for the State is from the permitted issues, so it is permitted for the State to create a specific currency, and in the same way it is permitted for the State not to do so. So to issue a currency is not obligatory upon the State, unless safeguarding the economy of the land from ruin and protecting it from its enemies required the issuing of a currency, at which point its issuance would be obligatory.

It's forbidden to link our currency to a foreign currency as that "would make the State follow whichever disbelieving state it links its currency to (leaving us) at the mercy of that disbelieving state from the financial angle." (Article 166 of the Draft Constitution)

That currency will be restricted to gold and silver, whether minted or not. No other form of currency for the State is permitted.

"The State can issue coinage or paper currency, as a substitute for gold or silver provided that the Bayt Al-Mal has the equivalent amount of gold and silver to cover the issued coinage." And we are not permitted to allow any other currency into the lands of the Islamic State if it would cause harm to our currency, finance or economy…. "This is applied to exporting the currency of the State, and importing and exporting foreign currency, in the same way that it is applied upon the transactions within the State." (Article 167 of the Draft Constitution)

Allah has provided the Muslim World with the materials to make this possible. We have the gold and we have the silver. The problem is that we don't currently have any control over it. And we are divided, so the resources in one part of the Muslim lands is not accessible to the Muslims in the rest of the Muslim lands. This will change once the Khilafah is re-established on the Method of the Prophethood though it may make it difficult for us to picture the reality today.

That's why it's important to understand that things have to change when the Khilafah (Caliphate) comes, and why we cannot apply the Islamic laws within the Capitalist System that is ruling over us today.

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