The US Dollar-Dominated International Financial System and Its Impact on Global Economies

Overview of the Current System

The international financial system, as it stands today, is overwhelmingly dominated by the US dollar. This dominance stems from the post-World War II Bretton Woods Agreement, which established the US dollar as the global reserve currency. Even after the gold standard was abandoned in 1971, the dollar has remained central to global trade and finance, largely due to the size and influence of the US economy, the strength of US financial institutions, and the integration of the dollar into global commodity markets, notably through the petrodollar system for oil.

Benefits to the US and Western Economies

1. **Reserve Currency Privilege**: The US dollar's status as the primary reserve currency gives the US considerable financial advantages. Countries around the world must hold dollars to facilitate trade, meaning there is a constant demand for dollars. This allows the US to borrow cheaply and finance its large deficits at lower interest rates than would otherwise be possible.
2. **US Dollar-Denominated Loans**: Many developing nations, especially in the Global South, borrow in US dollars rather than their local currencies. This exposes them to several risks:
   - **Interest Rate Dependency**: Developing countries face the effects of US Federal Reserve policy, as they are subject to interest rate changes set by the Fed, which can increase the cost of servicing dollar-denominated debt.
   - **Currency Risks**: Fluctuations in their local currencies against the dollar mean that if their currency depreciates, the cost of paying back dollar-denominated debt rises, often leading to debt crises.
   - **US Economic Influence**: Even countries with stable economies and policies are affected by US economic conditions, as US monetary policy has global repercussions.
3. **Trade Settled in Dollars**: International trade is heavily reliant on the US dollar. Countries trading with one another, such as Brazil and Turkey, must often use dollars to

settle transactions, even when the US is not involved in the trade. This structure benefits:

- **US and Western Financial Institutions**: Banks and financial centres in New York and London profit by processing these transactions. The global reliance on the dollar means that the US and its allies earn income from transaction fees and enjoy increased capital flows, even when they are not directly part of the trade.
- **Global Dollar Liquidity**: The global demand for dollars keeps the currency in circulation, which supports US economic policy and allows the government to borrow internationally with ease.

How This Penalises Developing Economies

1. **Outflows of Wealth**: Developing countries often find themselves accumulating dollar reserves or servicing dollar-denominated loans, which results in large outflows of capital from their economies. This limits their ability to invest in their own development, especially in infrastructure, healthcare, and education.
2. **Economic Vulnerability**: By being tied to US economic policy through the use of the dollar, developing economies become highly vulnerable to external shocks. When the US raises interest rates, for example, borrowing costs for these countries increase dramatically, leading to financial strain.
3. **Impeded Domestic Investment**: The need to service dollar-based debt and accumulate foreign reserves hampers the ability of Global South economies to reinvest in their own infrastructure and services. Much of their wealth is channelled back to Western financial centres, primarily Wall Street, draining resources that could otherwise foster local growth.

Russia’s BRICS Proposal: A Shift Towards Local Currencies and Commodities

In response to the constraints of the dollar-dominated system, Russia has proposed a new framework for international trade settlements within BRICS (Brazil, Russia, India, China, and South Africa) that emphasises the use of national currencies and commodities as alternatives to the US dollar.

Key Features of Russia’s Proposal

1. **Settlements in National Currencies**: The proposal calls for BRICS nations to settle trades using their own national currencies rather than defaulting to the US dollar. This would allow countries like Brazil and Turkey, for example, to trade directly in Brazilian real and Turkish lira, reducing dependency on Western financial institutions.
2. **Commodity-Based Settlements**: In addition to currency settlements, Russia advocates for allowing commodities to be used in trade agreements. For instance, Russia might choose to accept rice from India in exchange for natural gas, reflecting the tangible value of goods. This offers countries the flexibility to use their resources to settle trade imbalances rather than accumulating foreign currencies, which may not always be

beneficial. For example, while rice is useful and can be consumed, a foreign currency like the Indian rupee might not always be advantageous if it fluctuates or is not widely needed.

3. **Flexibility for All BRICS Nations**: The commodity-based system is not limited to any one trade partnership. It allows for all BRICS members to settle trade agreements either in local currencies or by using commodities based on what best suits the circumstances of each trade deal. This could empower nations that are rich in natural resources but lack the reserve currencies needed for international settlements.
4. **Multilateral Clearing Mechanism**: Russia also proposes establishing a multilateral financial clearing system among BRICS nations, which would allow for trade to be settled directly between members without relying on Western-dominated financial structures such as SWIFT.

Advantages for Developing Economies

- **Reduced Exposure to US Dollar Volatility**: Settling trades in local currencies or commodities reduces the vulnerability of developing nations to US dollar fluctuations and the policies of the Federal Reserve.
- **Increased Economic Sovereignty**: By freeing themselves from dollar-denominated debts and trade obligations, developing countries can reclaim more control over their financial systems.
- **Trade Flexibility**: Commodity-based settlements provide greater flexibility in structuring trade agreements, particularly for countries that may have abundant resources but insufficient currency reserves.

Potential Challenges

1. **Commodity Price Volatility**: While commodities offer a tangible value, their prices can fluctuate significantly, introducing a different kind of volatility into trade settlements. For example, if the price of rice or natural gas drops after a deal is struck, the value of the exchange could be impacted.
2. **Logistical Costs**: The transportation, storage, and quality management of commodities involve additional costs compared to currency-based transactions, which could complicate large-scale trade agreements.

The Belt and Road Initiative (BRI) and Its Impact on Global Trade

China’s Belt and Road Initiative (BRI), known as **One Belt One Road**, complements the vision of a more balanced global trading system by reducing transportation costs and fostering connectivity between regions.

Key Features of the BRI

1. **Six Major Land Corridors**: The BRI aims to connect China with Europe, Asia, and Africa through a network of land corridors linked by roads, railways, energy infrastructure, and digital networks. These corridors are designed to make the movement of goods more efficient, which will drive down costs and increase trade volumes.
2. **Maritime Silk Road**: The initiative also focuses on upgrading ports and maritime infrastructure, making shipping lanes faster and more cost-effective.

How the BRI Supports the BRICS Trade Vision

- **Reduced Transportation Costs**: By improving infrastructure, the BRI reduces the logistical costs associated with transporting commodities. This makes the option of settling trade with physical goods more feasible and efficient, complementing the commodity-based trade framework proposed by Russia.
- **Enhanced Connectivity**: The improved road, rail, and port infrastructure will streamline trade between BRICS nations, allowing them to take advantage of the flexible settlement options that Russia has proposed.

Would This Be a Fairer System?

The proposed shift away from a dollar-dominated global financial system to one based on local currencies and commodities is likely to create a fairer and more balanced economic landscape, especially for developing countries. The combination of Russia’s BRICS proposal and China’s BRI could empower developing nations in the following ways:

- **Reduced Dependency on US Economic Policy**: Developing nations would no longer be as dependent on the US dollar, protecting them from the volatility of US interest rate hikes and currency fluctuations.
- **Increased Investment in Domestic Infrastructure**: By keeping more of their wealth within their own economies, countries in the Global South would have more capital to invest in critical infrastructure and social services.
- **Greater Flexibility in Trade**: Nations could choose to settle trade agreements in whatever form is most convenient for them, whether that be local currency or commodities, enhancing their bargaining power and financial stability.

However, for Western economies, particularly the US, this would represent a loss of the financial advantages they currently enjoy. Reduced demand for the US dollar and diminished global influence of US financial institutions could lead to weaker economic leverage and higher borrowing costs.

Conclusion

The current US dollar-dominated international financial system disproportionately benefits the US and Western economies while penalising the Global South. Russia’s proposal, combined with the infrastructure improvements brought by China’s BRI, presents a path towards a more equitable system. A move to local currencies and commodities in international trade would offer developing countries more economic autonomy, reduce their dependency on Western financial institutions, and enable greater investment in their domestic economies. This shift, while challenging to implement, holds the potential to create a fairer global economy where wealth and opportunities are more evenly distributed.

See also:

- mBridge project accelerates CBDC adoption amid global financial shifts

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