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Insights

US dollar confronts another threat

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Russia says BRICS nations plan a common currency

The US dollar is the dominant currency in global finance and commerce. Some nations chafe at the dollar's role in world trade and financial affairs and look for opportunities to diminish that currency's importance. The August 22 - 24 summit in South Africa for leaders of the BRICS nations – Brazil, Russia, India, China and South Africa – had been the hoped-for setting for the announcement of a BRICS gold-backed currency to challenge US dollar supremacy.

Statements and counterstatements

The Russian embassy in Kenya leaked word of the common currency in a July 2 tweet followed by similar statements a few days later from Russia Today, a state-supported television network.

In a July 5 interview, Leslie Maasdorp, Vice President and Chief Financial Officer of BRICS-supported New Development Bank, downplayed the creation of a US dollar competitor. Mr. Maasdorp said that the US dollar is the Bank's anchor currency and that the Bank is firmly embedded in the US dollar hemisphere. Mr. Maasdorp commented that "No one is suggesting right now that BRICS will form an alternate currency." The CFO noted that if a new currency were developed, it would be a medium- to long-term ambition.

South African officials dashed the hopes of many when the summit host stated that the agenda would not include common currency discussions. Instead, the attendees discussed ways to boost the use of their local currencies in trade and financial transactions to reduce reliance on the US dollar.

Russian frustration

Russia's desire to dislodge the US dollar is not surprising. In response to the Ukraine invasion, a US-led coalition levied a series of sanctions on Russia. The coalition capped the price of Russian crude oil; blocked Russian banks from using SWIFT (the US-managed global payment system); and froze Russian currency reserves. Russia has had some success countering the sanctions, but currency issues are stifling that advancement. This is because Russia must substitute other currencies for the off-limits US dollar, and getting around the US dollar's dominance in global commerce is not easy.

China and India have supported Russia with energy purchases in currencies other than US dollars. Mostly that's been Chinese yuan for about $60.3 billion in oil imports. While trading with China seems to effectively evade the sanctions, trading with India has been troublesome because India has insisted on paying for Russian energy in Indian rupees, but the Russian energy companies are unable to convert rupees to another useful currency because of the sanctions. And spending rupees is difficult because India only has a two percent share of global exports. In other words, no one wants rupees. As a result, India and Russia have stopped negotiations about settling trade in rupees.

Brazil's common currency experiences

Brazil has considerable experience – all dismal – in launching a common currency. In 1987, Brazil and Argentina tried to launch the gaucho, but that effort was dropped among economic turbulence the following year. In 2019, Brazil and Argentina proposed another currency collaboration, the peso real. The Brazilian central bank opposed it, despite the Brazilian president's insistence that the currency project would move forward. The central bank won, and the matter was quietly forgotten. Those two countries tried again in early 2023 to develop a new currency, the sur (the south), but gave up when other South American countries declined to take part and when the Brazilian central bank refused to support it.

Forgotten lessons about gold standards

The history of gold-backed currencies might give the BRICS countries reasons to reconsider using that precious metal to back their currency.

Gold advocates point to the period from the end of the US Civil War in 1865 to the beginning of World War I in 1914 as justification for a gold standard. The world experienced a relatively calm political environment, strong economic growth, and absence of major wars (except the Spanish American War in 1898). Those conditions were, in part, attributed to the gold standard, although many historians believe the standard was more of a consequence than a cause.

Whether it was a significant cause or a result of that mostly tranquil period, gold's shine diminished after World War I. Combatant nations had taken themselves off the gold standard to finance the war. After hostilities ended, nations tried to reestablish the gold standard by increasing interest rates to attract capital and rebuild gold levels. Those higher rates meant lower levels of business production and substantial increases in unemployment. Unemployed workers led to lower demand, causing prices to decrease. Deflation intensified and led into the Great Depression with its almost unimaginable social, economic and political catastrophes. The worldwide distress led to the rise of National Socialism in Germany and fascism in Italy, events that contributed to World War II.

Despite its disastrous part in post-World War I affairs, gold played a prominent role in the Bretton Woods financial system that governed international trade and finance after World War II. Named after the United Nations Monetary and Financial Conference held at Mt Washington Hotel in Bretton Woods, New Hampshire in 1944, the United States committed to converting US dollars to gold at $35 per ounce, a de facto gold standard. Nations would maintain their currencies at a fixed exchange rate solely with the dollar. That financial structure worked until numerous economic problems in the United States prompted President Nixon to halt gold conversions in 1971. That wasn't enough to counter speculative currency attacks, and so the US and other governments were forced to let their currencies float in March 1973, effectively ending the post-war gold standard.

It's hard to overthrow the king but it's not impossible

Deposing the US dollar from its global role is a daunting task. Commodities are priced in USD, debt is often issued in USD, and many goods and services are invoiced in USD. The United States offers ample investment opportunities for those holding excess dollars and has well-defined and established laws for governing finance and trade. Those benefits might be ignored if the US continues to impose economic sanctions to punish its enemies; those penalties might offer the impetus to create and use another currency.

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