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THE TWILIGHT OF THE US DOLLAR HEGEMONY AND THE COMING MULTIPOLAR WORLD

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Introduction

The US has emerged as the world's only superpower in the aftermath of the Cold War, effectively establishing itself as the global hegemon. The secret to United States' success in the Cold War and the post-Cold War era was its tremendous economic strength that enabled it to easily outspend every potential rival power in terms of military capabilities (Berkowitz 2003, 5). As pointed out by Michael Beckley, the US government has been spending in average half a trillion dollars per year on weapons, amassing "an arsenal of thousands of ships, aircraft, vehicles, satellites, R&D labs, radar installations, ammunition stockpiles, testing and training facilities, and bases" (Beckley 2018, 53). US defense spending amounts to only 3.74 percent of the US GDP, which means that US military superiority does not impose an extraordinary economic burden on American society. However, US hegemony may be also much more fragile than what conventional wisdom suggests: not only are military capabilities far less useful as political tools in a world characterized by complex interdependence and frighteningly large nuclear weapons stockpiles, the very foundation of US geoeconomic dominance has now become shaky, namely the USD. The USD has been described as the "soft underbelly of the American empire" and this underbelly has come under attack (Hensman and Correggia 2005, 1091-1095).

The article argues that the US rise to global dominance would not have been possible without making the USD the most important world reserve currency. The USD almost failed as a dominant reserve currency in

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the 1970s but was eventually propped up by the energy-backing of the USD. In the early 2000s the US government realized that it could use the USD as a most powerful weapon against adversaries, which ultimately encouraged the development of parallel global financial institutions by the BRICS nations. The unprecedented financial sanctions by the US and the EU against Russia in response to the invasion of Ukraine in February 2022 may have further eroded the global attractiveness of the USD as a world reserve currency. If, or when, there would be a viable USD alternative, the USD would decline in value, making it far less affordable for the US to military maintain a global presence and to function as the global policeman. The consequence will be the emergence of a new multipolar order.

The Bretton Woods System

Britain created a global financial system by establishing the first international gold standard, also known as the classical gold standard, which was operational from 1880 to 1914 through the Bank of England. The standard was during that time jointly maintained through the four core nations Britain, Germany, France, and the US (Gallarotti 1995, 11). The classical gold standard has been widely praised as having been effective in terms of maintaining monetary stability, strengthening the growth of international trade, and enabling economic expansion and high employment rates (Gallarotti 1995, 18-19). The gold standard came to a sudden end with the beginning of the First World War. The new gold exchange standard that replaced the classical gold standard during the interwar period, was ineffective due to the lack of a strong hegemonic power that could guarantee it.

In order to lay the foundations for a new global financial system, delegates from 44 countries met at a hotel in Bretton Woods, New Hampshire in July 1944. It was decided to create two key institutions, the Bank for Reconstruction and Development (World Bank) and the International Monetary Fund. The function of the World Bank is to provide loans to countries for economic reconstruction and development, while the function of the IMF is to provide funding in order to solve temporary payment problems (Eichengreen 2021, 555). The Bretton Woods System was based on a gold standard that was to be maintained by the US government, which promised to keep USDs convertible to gold at a rate of $35 per ounce (Cesarano 2006). All other currencies were to be pegged against the USD with the expectation that all central banks would maintain the value of their currency within an agreed range.

The Bretton Woods System became brittle as more countries were forced to devalue their currency relative to the USD. For example, the Bank of England had to devalue the Pound two times in 1949 and 1967 (Eichengreen 2021, 555). In the 1960s the US government moved to an arrangement known as the Gold Pool, where several major countries cooperated in maintaining an international distribution of gold reserves. The arrangement was, according to Barry Eichengreen, enabled by the US "applying economic, financial and geopolitical leverage" (Eichengreen 2021, 555). Due to high government expenditures in relation to the Vietnam War and resulting inflationary pressures, the Bretton Woods System ended in 1971.

Many of the current challenges to the global financial system originate from Nixon's decision to close the gold window in August 1971. This effectively devalued the USD and created an entirely new global financial system (Dalio 2021, 347-348). Currencies began to fluctuate in a much greater range against each other than under the Bretton Woods system. Not surprisingly, the end of the gold standard caused severe inflation in the US throughout the 1970s. By the late 1970s, the USD was already failing as a world reserve currency. In order to stabilize the USD at the beginning of increasing inflation after closing the gold window, the Nixon administration began high-level negotiations with Saudi Arabia that they would sell their oil only against the USD (Clark 2005, 20). Out of a secret agreement with Saudi Arabia grew two pillars of the new global financial system: petrodollar recycling and the development of IMF Special Drawing Rights (SDRs). Petrodollar recycling refers to the practice that oil exporters in the Middle East would reinvest a portion of their oil profits in the financial markets of Europe and the US. The SDRs, on the other hand, represent a basket of currencies in accounts held by IMF member states that they can use for settling international debt. The SDRs were first introduced in 1970. Petrodollar recycling began in 1974 when Saudi Arabia secretly bought $2.5 billion in US Treasury bonds (Clark 2005, 20).

Since most countries in the world need to import energy and since some of the biggest exporters of energy now demanded USD in exchange, more international demand for the dollar was created, which stabilized the value of the USD. Petrodollar recycling further ensured that substantial amounts of USD and USD-denominated financial instruments would be held by foreign powers long-term, which thereby further artificially tightened the USD supply. About 80 percent of all international oil sales are currently conducted against USD (Budryk 2022). What is now called the petrodollar is the idea that the USD is backed by oil by virtue of countries having to hold USD in order to purchase energy on the global market.

The advantages for the United States of USD hegemony are substantial, as argued by Zarate: "The standing of the dollar allows the United States to shape the global economic and political system and offers greater influence abroad, greater flexibility at home, and greater insulation from international crises" (Zarate 2013, 399). USD hegemony also allows the US government to borrow money for financing a substantial trade deficit and to sustain levels of national debt without a severe devaluation of the currency.

The Weaponization of the USD

The dominance of the USD in the global financial system provided the US government occasionally with opportunities for coercing allies such as Britain during the Suez Crisis of 1956 (Katz 2014, 79). However, it was not before the era of globalization during the 1990s that the USD became useful as a weapon that could be wielded with great effectiveness against enemies. Paul Bracken argued that it was the tremendous growth of the international financial system and the dominance of the USD in international currency transfers that has enabled targeted financial warfare analogue to precision strikes in modern warfare (Bracken 2007, 685). Juan Zarate was among the first to explain how the US Treasury has used financial warfare, which he defines as the "use of financial tools, pressure, and market forces to leverage the banking sector, private sector interests, and foreign partners to isolate rogue actors from the international financial and commercial systems and eliminate their funding sources" (Zarate 2014, 88). As Blackwill and Harris have argued, "[t]hanks to the dollar's continued universality and America's central role in financial markets, the U.S. Treasury is able to deliver a credible ultimatum to international banks: either do business in the U.S. dollar or do business with the target country or bank" (Blackwill 2016, 58-59). In other words, the US Treasury can cut off banks from the international banking system if they do not play ball and comply with US demands.

The US Treasury has waged financial war against a wide range of adversaries. Al Qaeda was targeted with financial sanctions under UN Security Council Resolutions 1267 (1999) and 1373 (2001), which meant that all suspected terrorist assets could be frozen in the international banking system (Zarate 2013, 33). After al Qaeda Iran became a major target of US financial warfare for the country's violations under the Nuclear Non-Proliferation Treaty. The country is particularly vulnerable to financial sanctions targeting the energy sector as 80 percent of its foreign currency reserves and 50 percent of its budget are derived from oil exports (Katz 2014, 83). On 15 March 2012 Iran was cut off from the SWIFT international payments system, which directly impacted its ability to export oil due to the difficulty of buyers making payments (Zarate 2014, 88). Overnight, Iran lost between $45 billion and $50 billion in oil sales, which crashed its currency, the Rial, and caused massive inflation at 25 percent per year (Torbati 2012).

The rise of BRICS

The Chinese and Russian governments have been outspoken against the weaponization of the USD and have worked towards reducing their USD holdings and their dependence on the USD as a means for international payments. Furthermore, they have been creating financial institutions in parallel to the World Bank and IMF, which is already threatening USD hegemony. Of particular concern is China's new Asian Infrastructure Investment Bank (AIIB), which US officials have called out as an attempt to undermine the financial institutions created after the Second World War (Blackwill and Harris 2016, 115). Russia has established the BRICS group of nations (Brazil, Russia, India, China, and South Africa) in 2009 as an annual summit to bring together the leaders of emerging economies to discuss avenues for cooperation. Out of this annual summit came the commitment to a BRICS bank modeled after the World Bank and capitalized with $100 billion, which is called New Development Bank (NDB) (Blackwill and Harris 2016, 74). Unlike the AIIB, which has attracted many states beyond BRICS and Asia as members, including some Western states, the NDB is primarily composed of BRICS countries (Cooper 2017, 275). It is the BRICS bank and it has built up its capital base through the innovative way of issuing bonds in BRICS national currencies, thus bypassing the USD (Cooper 2017, 276).

China and Russia have already agreements in place to conduct trade with their respective currencies, circumventing the USD. China, Russia, Iran, Venezuela, and a growing number of other nations are in process of developing digital currencies (CBDCs) that could be used for international payments. China already conducted a test launch of its own digital yuan in Shenzhen in September 2020 in view of rolling out the currency nationwide within a few years. Most recently, Iran announced its new CBDC called Ramzrial in September 2022, which is a digital version of its regular currency, the Rial (Dudley 2022). It is not hard to guess why nations that are US competitors and adversaries would want to switch to CBDCs: they can more easily circumvent sanctions, they can exercise far more control over their currency, and they are no longer vulnerable to financial warfare in the form of asset freezes.

The next step would be to develop a basket of BRICS currencies that not only enable the international transfer of funds via alternative payment systems but also function as a new global reserve currency, which means that it must be a stable store of value (Molodiko 2020, 73). The first step towards this goal has been taken by the development of BRICS Pay, an intra-BRICS payment mechanism, which functions as an alternative to the American Visa and Mastercard payment systems Losev 2019). In June 2022 President Putin announced a BRICS basket-based reserve currency modeled after the IMF Special Drawing Rights (SDRs), which could compete with the USD as a stable world reserve currency (Birch 2022).

Blowback from the Ukraine War sanctions

On February 24, 2022, Russia invaded Ukraine, taking large swaths of eastern, southern, and northern Ukraine. In response, NATO has implemented a hybrid warfare strategy that consists of arming and training Ukrainian forces and of waging economic warfare to ultimately turn Russia "into North Korea, completely isolated economically and diplomatically" (Myre 2022). The US and the EU targeted Russia's economy by attacking Russia's finances and ability to profit from energy exports. The idea is that by strangling the Russian economy Russia would be forced to end the war in Ukraine and withdraw from all the territories that it currently occupies.

The US government and the EU have frozen $300 billion of Russia's foreign reserves (Tan 2022). This act temporarily weakened the ruble overnight and caused domestic price levels to increase. Freezing Russia's foreign reserves has the aim of hindering Russia's ability to pay off its international debts and imports in foreign currency, forcing countries to use the ruble. Like Iran, Russia has been disconnected from SWIFT (Norrlöf 2022). This means, Russia can no longer do cross-border financial transactions effectively delaying any payment for Russia's exports, which substantially reduced the ability of Russia to export oil to the EU since Russia no longer can receive payments in Western currencies.

In order to make exports more difficult, Western insurance companies have withdrawn coverage from Russian vessels that need the coverage for accessing ports and generally conducting business (Saul 2022). Other sanctions imposed on Russia include travel bans for the Russian elite, closing off the European and American airspace to Russian flights, restricting oil/gas equipment, banning all imports from Russia, asset freezes on President Vladimir Putin and Russian Foreign Minister Sergei Lavrov as well over 350 politicians and oligarchs, restrictions on USD through sanctioned state-owned banks and other financial institutions, and the removal of Russia from "most-favored nation" status bringing significant increases in tariffs (Lin and

O'Donnell 2022).

The Western financial, trade, and other sanctions have clearly fallen short of limiting Russia's ability to continue its military operations in Ukraine, as the war has dragged on for almost a year. The value of the ruble, which is highly dependent on energy prices and Russia ability to export energy, has not collapsed. Europe continues to buy natural gas from Russia but is now forced to use rubles as a means of payment (Jewkes and Wacket 2022). In fact, the exchange rate for rubles to USD has remained remarkably stable (after a temporary spike in March 2022) at around 70-75 rubles per USD. The impact on the Russian economy was moderate with a likely drop in GDP of only 3.3 to 3.4 percent for 2022 (NPR 2022). The Russian economy has proven to be more resilient than expected.

Given that it was the first time that a major economy was subjected to freezes of central bank assets, as well as assets of certain private individuals, and a removal from SWIFT, other US competitors and potential adversaries must be concerned about the possibility that they could be next if they ran afoul the rules imposed by the US government. In particular, China must be greatly concerned about how any move they make against Taiwan could result in financial warfare by the West, which is likely to force them into a decision of either abandoning a reunification with Taiwan or reduce the impact of likely future US financial sanctions by dumping USD holdings and aggressively promoting the yuan as an alternative payment option for international trade.

The end of the "petrodollar"

The idea that financial warfare could undermine USD hegemony is not a new one and it has been considered repeatedly by several experts over the last two decades. For example, Zarate has warned that "the US dollar – and its predominance – is a target for competitors and those who bemoan the world's reliance on the dollar as the accepted reserve and trading currency as the central element of US financial power" (Zarate 2013, 394-395). Since the USD is implicitly backed by energy due to the promise of Saudi Arabia to only export their energy against USD, thereby forcing other nations to maintain large USD reserves to buy energy, an attack on the USD might target the US special relationship with Saudi Arabia.

It has been noted that US ties with Saudi Arabia have been weakening over the last decade. In April 2016 the Saudi government threatened that it would sell off $750 billion worth of US Treasury bonds in the event of them getting held liable in US courts for 9/11 after the release of the 28 missing pages of the 9/11 Commission report (Wong 2016). The relationship was further harmed by the scandal surrounding the murder of Jamal Kashoggi in the Saudi embassy in Turkey in 2018. There have been concerns for years that Saudi Arabia could renege on the deal made in the 1970s and sell oil in a currency other than USD. China, which imports 25 percent of all the oil exported by Saudi Arabia, has been negotiating for several years with Saudi Arabia to buy oil in yuan (Said 2022).

Saudi Arabia initially stated they would not accept yuan but might in the future sell oil against a reference basket of currencies (Economist 2022). They reversed course in January 2023 to announce their willingness to trade oil against other currencies, presumably also the yuan (Omar and Cranny 2023). If that were to happen, it could over time result in more energy being traded against other currencies, thus undermining the need for other countries to hold the USD as a reserve. This may negatively affect the willingness of countries to accept USD as a means of payment for exports to the United States.

What may be indicative for a Saudi Arabia defection from its partnership with the US is that it is not condemning Russia's invasion of Ukraine and is actually seeking closer ties with Russia through OPEC+ (Economist 2022). The Saudis also plan the purchase of a number of advanced Russian weapons systems, including the S-400 air defense system, the Su-35 fighter jet, and the Kornet anti-tank missiles (Episkopos 2021). The US has been Saudi Arabia's primary protector and supplier of arms for 50 years. It is therefore a worrying sign that the Saudis want to buy weapons from a US adversary, which may indicate that the country could change its strategic allegiance from the West to the East (Russia and China).

A BRICS currency

Up to now, the USD has not faced any serious challenge until the introduction of the Euro in 1999. The Euro was only initially seen as a viable competition to the USD as the leading world reserve currency (Bergsten 1997, 83-95). The financial crisis of 2008 almost led to a crash of the global financial system, and it revealed the weakness of the EU and its ability to cope with the high indebtedness of some of its major members. Due to the need to bail out banks that had toxic assets on their balance sheets and in order to save the global financial system, US national debt increased sharply from 2008 to 2009. US national debt measured in percentage of the US GDP increased from 68 percent GDP in 2008 to 86 percent in the first quarter of

2010, eventually peaking at 135 percent in the second quarter of 2020 (Federal Reserve 2022). The increased borrowing of the US government in the years following the 2008 financial crisis was heavily criticized by some of the larger foreign holders of US debt, most notably China. In 2013 during the partial US government shutdown and with the possibility of US debt default the Chinese government issued a statement that they wanted to "de-Americanize" the world (Sherwell and Moore 2013). This was a thinly-veiled threat to dump US debt and thereby weaken the stability of the USD.

The Chinese yuan is now more widely held as a reserve currency but only takes three percent of the share of foreign reserves held by other states (as compared to 60 percent for the USD). The Chinese economy is not strong enough and the People's Bank of China is not trusted enough to make the yuan a viable competitor to the USD. However, the greatest threat to the USD hegemony is not the yuan: it is the prospect of the development of a new BRICS currency, which could be gold-backed or commodity-backed.

The BRICS group has been openly discussing a new BRICS currency that could replace the USD as a medium of exchange for intra-BRICS trade since at least 2011 (Sule 2011, A14). China and Russia have already agreements in place to conduct trade with their respective currencies, circumventing the USD. The next step would be to develop a basket of BRICS currencies that not only enable the international transfer of funds via alternative payment systems but also function as a new global reserve currency, which means that it must be a stable store of value (Molodiko 2020, 73). The first step towards this goal has been taken by the development of BRICS Pay, an intra-BRICS payment mechanism, which functions as an alternative to the American Visa and Mastercard payment systems (Losev 2019). In June 2022 President Putin announced a BRICS basket-based reserve currency modeled after the IMF Special Drawing Rights (SDRs), which could compete with the USD as a stable world reserve currency (Birch 2022).

Western analysts generally dismiss the possibility of the USD getting dethroned as the dominant world reserve currency as very unlikely, mainly due to the lack of a viable USD alternative in the global financial system. For example, Elliot Hentov, Ramu Thiagarajan, and Aaron Hurd have argued in relation to the unprecedentedly extreme Russia financial sanctions:

> Do these historic sanctions signal the end of the dollar's dominance? We believe that any imminent change is highly unlikely. Paradoxically, the recent events may have even buttressed reliance on the dollar and highlighted its appeals: deep and liquid capital markets; traceability and convertibility; and network effects. In the long run, any alternative needs to be able to

compete on those metrics (Hentov, Thiagarajan, and Hurd 2022).

It is true that the USD is unbeatable in terms of liquidity, it may also a factor in the USD's downfall. Here it is important to consider that there is a difference between the relative strength of the USD in relation to other currencies and the absolute strength of the US in terms of purchasing power. Reckless spending is destroying the value of the USD and its capability to function as a store of value, which will affect other powers to look for a better alternative if or when such an alternative would arrive.

Conclusion

Since the beginning of the COVID-19 crisis in early 2020 the world has arguably entered an era of de-globalization. Global supply chains have experienced some disruption during the period of the US-China trade war and have been breaking down due to government responses to COVID-19, as well as due to disruptions caused by the war in Ukraine (Rickards 2022, 42). This has already resulted in shortages across different types of goods such as certain food items, car parts, computer chips, and other consumer goods. Once broken, supply chains are very difficult to reestablish since they are so incredibly complex. As James Rickards has argued, "[t]he system is extremely frail. One missed delivery can result in an entire assembly line shutting down. One delayed vessel can result in empty shelves. One power outage can result in a transportation breakdown" (Rickards 2022, 60). The growing military tensions between the US and China will likely lead to further disruptions and subsequent shortages. The other factor that these problems cannot be easily fixed or fixed any time soon is that they are also caused by major political shifts and geostrategic realignments that will shape the future of the world.

US elites increasingly understand that globalization or the "liberal world order" is being challenged by BRICS and may fail altogether. The World Economic Forum has published a series of articles that discuss the question whether the liberal world order will succeed or whether it will collapse and be "replaced by something fundamentally different" (WEF 2023). National Security Advisor Jake Sullivan recently stated that the world was at an "inflection point" with the post-Cold War era being over, and that the 2020s would be a decisive decade that would decide "what comes next" in terms of world order (Sullivan 2022).

For now, the US economy remains stronger than others, but it is also facing serious headwinds. Although not yet officially acknowledged, the US has or will very soon enter a recession that is accompanied by high inflation. US inflation may have slowed since summer 2022 but it remains at a 40-year high with no end in sight. Most governments of the world, including the US, have massively increased their debts in response to COVID-19, which has resulted in unsustainable levels of national debt. The US national debt now exceeds $31 trillion dollars. The US General Accounting Office has pointed out that the "federal government faces an unsustainable fiscal future" (US GAO 2022). US national debt is projected to reach 200 percent GDP by 2050 (US GAO 2022). Due to escalating national debt levels the USD has subsequently suffered significant devaluation in absolute (but not relative) terms against hard assets such as gold or other commodities. Ray Dalio has argued that "[t]he loss of reserve currency status is a product of chronic large devaluations" (Dalio 2021, 145). He also pointed out that "[o]f the roughly 750 currencies that have existed since 1700, only about 20 percent remain, and all of them have been devalued" (Dalio 2021, 132).

Should existing trends continue, it seems likely that the days of the USD as the world's number one reserve currency are numbered. Hentov, Thiagarajan, and Hurd may be right that USD hegemony may persist for longer but that the consequences of it ending would change the existing world order profoundly:

> One clear conclusion from the extraordinary weaponization of the dollar in the Ukraine war is that it serves to increase incentives toward financial fragmentation. Although the ability to move away from the current dollar-centric system is structurally limited for now, that structure can change over time. The economic costs of such change, particularly when considered alongside the broader effects of global fragmentation, may be very high indeed (Hentov, Thiagarajan, and Hurd 2022).

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ABSTRACT

USD hegemony is central to the primacy of the United States in the international system, perhaps even more so than US military superiority. The US government can afford to spend several times more on its military than its military competitors because it has the ability to sustain seemingly unlimited levels of debt thanks to the relative strength of the USD. Other nations have been willing to buy US debt and maintain large USD reserves, which has kept the value of the USD fairly stable in comparison to other currencies. The authors argue that there are clear signs that USD hegemony is declining and that this could lead to a multipolar world in which the United States is just one great power among others. The article will discuss the reasons why the USD is so central to US power, why the USD's attractiveness has been declining, and how the unprecedented Russia sanctions in response to the Russian incursion into Ukraine may have inadvertently accelerated the emergence of a multipolar world.

KEYWORDS

Geoeconomics. Petrodollar system. Financial warfare. Multipolarity.

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