

Study on the Trend of De-Dollarization

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Abstract. In recent years, "de-dollarization" has gained momentum globally, with major economies like China, Russia, Germany, the UK, Japan, and Canada implementing policies to reduce reliance on the US dollar. This trend challenges US dollar hegemony and fosters a shift toward a new world monetary order. This paper examines the "de-dollarization" trend, recognizing it as a persistent long-term phenomenon. While the US dollar's dominance may persist in the short term, its influence within the international monetary system continues to wane. Looking ahead, the trend toward diversification in international currencies will intensify, shaping a more varied global monetary landscape.

Keywords: De-dollarization, Dollar Hegemony, Digital Currency, International Monetary Diversification.

1. Introduction of De-dollarization

The US dollar has served as the centrality of the international monetary and economic systems since World War II. As the issuing nation of the dollar, the United States has reaped significant benefits. However, in recent years, the call of de-dollarization keeps rising from the major economies worldwide, including emerging market countries such as China and Russia, as well as developed countries such as Germany, the United Kingdom, Japan, and Canada. Following the outbreak of the Ukraine crisis, countries like Russia have accelerated the process of de-dollarization. This also, to some extent, accelerated the broader process of de-dollarization.¹

De-dollarization describes a process of moving away from the world's reliance on the U.S. dollar in international trade, finance, and reserves. The proportion of the US dollar in international payment settlements continues to decline. Major global economies, especially emerging countries represented by BRICS, are decreasing their reliance on the US dollar for international payment settlements. They are exploring various arrangements to increase the use of non-dollar alternative currencies for settlements, with some considering or already switching from dollar payments to bilateral currency settlements. In terms of investment, this is evidenced by actions such as reducing holdings of US assets such as Treasury bonds. For example, in 2022, China, Japan, France, Saudi Arabia, and other major holders of US bonds intensified their selling of US bonds in the first half of the year. Moreover, the attractiveness of US dollar reserves and assets is declining, leading to continuous selling and reduction of holdings. Central banks around the world are diversifying their reserve asset allocations. Many countries have taken measures such as increasing domestic gold reserves and augmenting reserves in non-dollar currencies.

2. Reasons for De-dollarization

2.1. Dollar Hegemony and the U.S. Economic Recession

Various incentives contribute to de-dollarization. After World War II, the Bretton Woods system underpinned the unique international status of the U.S. dollar being "pegged to gold". The subsequent Jamaica system further extended and strengthened the international status of the U.S. dollar despite the failure of fixed exchange rates. The U.S. dollar has maintained its position as a hard currency for decades, supported by the strong economic power of the United States, which instills full confidence in the value and solvency of the dollar held by investors. However, having experienced multiple economic crises, the confidence and trust in the U.S. dollar are gradually gone. And as global



economic dynamics have shifted, the diminishing share of the U.S. economy in the global economic landscape has led to a decrease in the value and creditworthiness of the U.S. dollar.

There exists an inherent contradiction in the dual role of the U.S. dollar as both a sovereign currency and a global currency. When the United States adjusts exchange rates to meet its domestic economic and political objectives, it has significant impacts on global economies. This has partly led to the phenomenon known as "dollar hegemony." In times of crisis the United States has utilized its dollar hegemony to externalize economic crises, resulting in inflation, economic downturns, and hardships for many countries. For instance, during global financial crisis in 2008, the United States leveraged its dollar hegemony through measures such as quantitative easing, involving extensive dollar printing and injection into the global economy. As a result, the repercussions of the financial crisis in the United States have had global ramifications, prompting various countries to take action to mitigate its effects. The exploitation of its international reserve currency status by the United States to extract global wealth and influence the economic and financial stability of other nations has faced widespread criticism.

Currently, the United States faces significant risks of economic recession. In 2022, due to persistently high inflation, the Federal Reserve began raising interest rates aggressively, profoundly impacting the international financial markets. This caused devaluation of currencies in other countries, increased debt servicing costs, capital outflows, and severely damaged the credibility of the U.S. dollar. Furthermore, apprehensions regarding U.S. debt have sparked considerable international anxieties. By 2013, the U.S. debt-to-GDP ratio had surged to 100%, and since then, the debt burden has continued to escalate, reaching \$30.93 trillion by 2022. International apprehensions regarding the potential default risk are steadily mounting. If a default were to occur, it would have catastrophic consequences for both the United States and global markets.

2.2. The Weaponization of the Dollar

The action of the United States to use the dollar as a political weapon is another significant driver for countries worldwide to pursue de-dollarization. As early as the 1980s, the rise of the Japanese and German economies challenged dollar hegemony. The share of the U.S. dollar in global reserve currencies declined from 80.3% in 1977 to 50.6% in 1990, with a corresponding increase in the shares of the German Mark and the Japanese Yen. In September 1985, pressured by the U.S. government, Japan, West Germany, France, and the United Kingdom signed the Plaza Accord, which involved collectively selling a large amount of dollars in the international foreign exchange market to significantly devalue the dollar. The Plaza Accord led to a doubling of the Yen's value against the dollar within three years, severely damaging Japan's export trade. Furthermore, after the dissolution of the Soviet Union, the United States solidified dollar hegemony by confiscating assets from countries in the Commonwealth of Independent States, including Russia. The share of the U.S. dollar in global reserve currencies increased from 51.3% in 1991 to 72.7% in the second quarter of 2001. By taking actions such as waging war in Iraq, imposing sanctions on Iran, and exerting control over Saudi Arabia, the U.S. successfully established a link between the dollar and long-term Middle Eastern oil trade. More countries had to perform de-dollarization to counter the pressures of dollar hegemony.

The recent sanctions imposed by the United States on Russia have rapidly accelerated the de-dollarization process. After the Ukraine crisis, the U.S. prohibited American individuals from providing financial services to Russia's major financial sectors. Subsequently, the U.S. expelled several major Russian banks from the SWIFT system, froze both Russian and foreign currency assets, declared certain Russian-held U.S. bonds invalid, and even confiscated the assets of Russian citizens abroad. The U.S. abused its control over global financial infrastructure to transform the dollar-centric international monetary system into a tool for financial sanctions, thereby altering its nature as a public good. In response to these challenges, Russia has begun exploring the use of the Ruble as an international trade settlement currency and is in the process of establishing a payment system based on the Ruble. The fractures in financial, industrial, and supply chains between Russia and some

Western countries, predominantly led by the United States, have catalyzed a notable pivot towards Asia. This shift is driven by factors such as diversification strategies, market expansion opportunities, and geopolitical realignments. The intensified competition among major powers like the United States, China, and Russia, coupled with the growing influence of emerging market countries such as China, Russia, and India, may accelerate the process of de-dollarization in Asia. These dynamics are likely to fuel Asia's economic resilience and bolster efforts towards establishing a more diversified currency zone. While the U.S. dollar may maintain significant influence, it is anticipated to face increasing challenges to its long-standing dominance over Asian currencies as regional economies seek greater autonomy and stability in their monetary frameworks.

Regarding European allies, the United States imposed sanctions on European companies involved in the Nord Stream 2 natural gas pipeline, further complicating the transatlantic relationship and raising concerns about European sovereignty in economic matters. These sanctions have intensified Europe's determination to reduce dependence on U.S. financial control and promote de-dollarization efforts. The widespread measures adopted by numerous countries to de-dollarize reflect the growing recognition of the need for international monetary diversification amidst geopolitical tensions and economic uncertainties.

2.3. The Evolution of the International Monetary System

The evolution of the international monetary system is intricately linked to the restructuring of the global economic landscape. The world economy is transitioning into a new phase characterized by a complex international trade and investment environment. It is also greatly influenced by the rapid expansion of the digital economy and the emergence of digital currencies

The ascension of emerging economies has significantly bolstered their influence within the international monetary system. Currencies such as the euro, renminbi, yen, pound sterling, Russian ruble, Turkish lira, and Indian rupee have gained prominence on the global stage. Simultaneously, there has been a surge in the usage of local currencies, leading to a fragmentation trend in the global monetary system. This shift has propelled the adoption of local currencies for settlement, emerging as a prominent agenda in regional economic and trade cooperation. Countries are increasingly seeking innovative trade settlement mechanisms and establishing bilateral or regional currency agreements to mitigate foreign exchange risks and ensure financial security. The development of cross-border payment and settlement systems by nations like China and Russia, alongside the maturation of cross-border payment blockchain technology, poses a challenge to the dollar's dominance in cross-border payments. This may facilitate a broader adoption of local currencies, circumventing the dollar in cross-border transactions. As regional economic cooperation deepens, there may be a surge in regional monetary arrangements, reshaping the current international monetary landscape and introducing innovations to the system. Consequently, the hegemony of the U.S. dollar may gradually wane, particularly in certain regions.

In addition to traditional national currencies, digital currencies are emerging as a significant force driving global "de-dollarization." The potential of digital currencies to substitute for the dollar in international investment and cross-border payments is increasingly evident. Major economies worldwide are exploring digital currencies, which offer a means to evade U.S. financial regulations and sanctions. Three types of digital currencies are poised to contribute to global "de-dollarization": digital fiat currencies like the digital renminbi, non-fiat digital currencies like Bitcoin and Ethereum, and digital currencies recognized as legal tender. While digital fiat currencies represent the future trend, with the digital renminbi spearheading the digitization of major currencies, non-fiat digital currencies face financial risks but are recognized by many nations for their ability to bypass U.S. financial control. Paradoxically, the U.S.-based international financial monopoly capital groups exert control over the world's major non-fiat cryptocurrencies and their derivatives. As the U.S. continues to exploit its dollar hegemony, the allure of digital currencies is likely to surge.

In fact, the dominance of the U.S. dollar has already encountered formidable challenges. The diversification of the international monetary system is the inevitable direction of its evolution. As global economic uncertainties mount, nations increasingly seek to diversify payment and settlement methods in trade, investment, and foreign exchange reserves to mitigate risks, which will undoubtedly continue to drive the exploration of international monetary diversification and therefore the unstoppable long-term trend of "de-dollarization."

3. Trends and Challenges

The growing uncertainty in the global economy has prompted countries to diversify their trade, investment, and foreign exchange reserve settlements to mitigate risks, driving further exploration of international monetary diversification. However, the choices of currencies with the functions of international reserve, pricing, and settlement, widely accepted by countries and fully convertible, remain extremely limited. In the short term, the euro and yen are still unable to replace the U.S. dollar as the preferred international currency choice. Thus, it may be premature to assert that the international monetary system is nearing "de-dollarization." Simply replacing the U.S. dollar with the legal tender of a single economy is not a viable alternative solution.

While the trend of weakening U.S. dollar dominance may accelerate temporarily, the fundamental pattern of its dominance is unlikely to change in the short term. The United States retains the long-term ability to dominate the world economy, maintaining its position as the leading financial power with over half of global bank loans and 40% of securities denominated in U.S. dollars. Despite signs of decline, the U.S. dollar will likely remain a world currency for a considerable period, serving as the main pricing currency in the world economy and the most widely accepted "hard currency" in the global economic system. "De-dollarization" does not entail a complete rejection of the U.S. dollar but reflects a need for "risk aversion" to reduce geopolitical sanctions and the spillover effects of excessive reliance on the U.S. financial cycle.

Local currency settlement does not necessarily weaken the U.S. dollar's global reserve and pricing currency position or lead to the end of "U.S. dollar hegemony." Countries opting for local currency settlement often have currencies that are not fully convertible, and their exchange rates are not entirely market-determined. Although local currency settlement represents a form of "de-dollarization," it does not fully achieve "de-dollarization" in trade pricing, as these countries still reference the U.S. dollar to determine exchange rates with counterparties. Instead, local currency settlement serves as a liquidity management tool based on the U.S. dollar, hedging against U.S. dollar liquidity risks while bearing default and exchange rate risks. Its primary purpose is not to "replace or exclude the U.S. dollar" but to expand choices in bilateral currency settlements, thereby promoting cross-border settlement currency diversification

The future international status of the U.S. dollar will continue to face challenges due to increasing competition in international trade settlement and the global reserve system. However, the fundamental determinant lies in the state of the U.S. economy and the direction of its policies, which are pivotal in determining the U.S. dollar's international monetary status. The "de-dollarization" trend largely depends on the U.S. economy and policies, particularly its fiscal and monetary policy choices. Inappropriate monetary policies can adversely affect the U.S. dollar, and the international market turmoil triggered by the U.S. financial crisis has also directly led to significant fluctuations in the U.S. dollar exchange rate. Economist Barry Eichengreen² argues that the U.S. dollar's ability to maintain its reserve currency status primarily depends on the United States' own policies, and serious economic mismanagement could lead to other reserve currencies replacing the U.S. dollar. For example, the U.S. policy of allowing large current account deficits to persist has led to the accumulation of massive foreign debt, triggering high inflation in the U.S. and U.S. dollar depreciation, making holding U.S. dollar reserves less attractive.

A currency's status is closely related to the economic strength, financial market openness, and stability of its sovereign state. If the U.S. economic fundamentals perform well and its fiscal and monetary

policies are sound, the international status of the U.S. dollar will be relatively stable; otherwise, it will be the opposite. In recent years, the global economy has been severely impacted by the COVID-19 pandemic, and the U.S. has entered an era of high inflation and high interest rates. In early 2023, when the U.S. debt reached the \$31.4 trillion statutory limit, the U.S. Treasury Department had to resort to "extraordinary measures" to ensure the government could continue to meet its obligations and avoid default, with the White House and Congress ending their negotiations on raising the debt ceiling in a "fiscal brinkmanship policy." While this temporarily averted a debt default, it may have long-term negative impacts on the U.S. economy. Compared to competition from other currencies, the U.S. dollar's status is primarily influenced by the U.S. domestic economy, especially its fiscal and monetary policies. It can be said that the key threat to the U.S. dollar's dominant position comes from within the United States.

The above analysis shows that while the U.S. dollar's status as the leading international currency is unlikely to be replaced in the short term, its position in the international monetary system has been continuously declining, and countries are actively seeking to reduce their over-reliance on the U.S. dollar in international trade settlement, cross-border payments, and financing. Therefore, the trend of international monetary diversification will become more pronounced, and a more diversified international monetary system will gradually take shape. In this system, the U.S. dollar will still play a dominant role as a major international reserve currency for a relatively long period, while the international monetary status of the euro, yen, and renminbi will further rise, regional currency cooperation will accelerate, and international currencies will become more dispersed and competitive. This means that if the international monetary governance system continues to lag, financial risks in the international monetary market may increase.

4. Addressing Risks and Realities

The risks of "de-dollarization" deserve adequate attention and preventative measures. The financial reform experiences of Latin American countries illustrate that "de-dollarization" cannot be pursued without considering its consequences.³ The relevant economic policy agenda must factor in both the current status of the U.S. dollar's international monetary dominance and the economic and financial realities of the country. It is necessary not only to study the "de-dollarization" trend and its underlying risk costs but also the complexity of international monetary diversification and its profound economic and political impacts. "De-dollarization" and international monetary diversification are not merely currency issues but also require a significant degree of macroeconomic regulation and political policy response.

Confronted with the increasingly prominent contradictions and risks in international monetary governance resulting from the accelerated "de-dollarization" trend, further strengthening the reform of the international monetary system is imperative. This necessity arises not from the political will or economic needs of any particular country but from the considerable gap in the multilateral governance system, stemming from both the lag in international monetary governance and the imperfect rule system, as well as the rapid development of current digital technologies, which have raised alarms about the heightened risks of global monetary and financial assets. In the future reform of the international monetary system, numerous new and unprecedented variables, such as cryptocurrencies and central bank digital currencies, will come into play. Presently, the world is undergoing a wave of financial innovations, epitomized by "cashless" transactions, and the new wave of financial innovations represented by "fintech" has brought a fresh impact on the international monetary system and brought new demands for global monetary management. In the future development trend, "de-dollarization" will coexist with international monetary diversification, and within this context, there will be no internationally recognized safe currency, and countries will focus more on the security, liquidity, and rate of return of currencies, while also considering the political role of currencies in international trade. The political nature of international currencies has long surpassed their intrinsic value, and in the context of de-dollarization and the slow pace of globalization, major economies are all seeking greater policy space, based on their domestic economies and the long-term interests of the

country, to consider how best to promote local currency settlement, regional currency cooperation, and financial market internationalization from both domestic and international perspectives. Especially for developing countries and emerging market economies, in addressing the risks brought by "de-dollarization," they should actively increase the activity of their local currencies in regional trade and their international negotiation capabilities, and actively participate in the construction of the international monetary system.

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