Russia Strikes out at Sanctions and Takes its Battle to the Dollar

By Stefan Hedlund
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The European Union sees a new deadline on implementing economic sanctions against Russia over the Ukraine crisis expire today, June 30, 2014. But Russia's President Vladimir Putin is turning the tables on the United States to spur a global 'de-dollarisation', writes Professor Stefan Hedlund.

Russia is making a concerted attack on the status of the America's greenback dollar as a global reserve currency and is in the process of abandoning the 'petro-dollar' as its trading unit for oil and gas.

Russian energy companies have been told to ditch the dollar and sign contracts in rubles and the currencies of partner-countries.

The desire to reduce the use of dollars is in line with China's aim to promote international use of the Chinese yuan. Other emerging market nations would also like to see reduced American hegemony.

An attack by Russia on the US dollar would be devastating and could, in theory, trigger a stock market collapse in the United States. However, the status of the greenback as global reserve currency is not yet under serious threat, for the simple reason that the alternatives are worse. But the Russian attack may prod the global economy to take a further step on the road to a system without a designated reserve currency.

If Central Banks across the world were to sell off their holdings of US government bonds, then the US economy would be flooded with dollars, causing the currency to plummet, inflation to spike and interest rates to skyrocket.

The consequent rise in the cost of financing government debt would be monstrous, and having to return to fiscal balance would force the closure of so many social spending programmes that there would be rioting in the streets.

It is unlikely this will happen, but it does provide a sobering background to the game Russia is playing, and what may eventually happen if Washington persists in refusing to get its own house in order.

Over the past few decades, the world has become so used to viewing the greenback as the 'natural' global reserve currency that warnings about a possible end to this way of cheaply financing the US deficit have been routinely shrugged off. Measures to prepare for a declining role of the greenback are not being implemented.

In the aftermath of the subprime mortgage crisis which triggered the recession in 2008, and the humiliating 2011 downgrade of the US sovereign credit rating, warning voices have begun to question how long this can go on. Those who are the biggest holders of US debt, mainly the BRICS countries (Brazil, Russia, India, China and South Africa), have begun looking for ways to move away from the dollar.

Ever since the collapse of the Soviet Union in 1991, Russia has been addicted to US dollars. During the turbulent 1990s, the greenback all but replaced the collapsing ruble offering both a means of exchange and a store of value. With the spike in oil prices which began in 2001, the Russian Central Bank has been able to stabilise the currency, and the role of the dollar has receded.

But the Russian economy remains heavily intertwined with dollar circulation, ranging from large holdings of dollars in foreign exchange (forex) reserves, to banks and enterprises indebted in dollars, to substantial offshore holdings in dollars, and above all to energy exports being traded in dollars. When threats of economic sanctions were made by the West, the Kremlin felt truly vulnerable. And it has moved to reduce this vulnerability.

Russian banking and energy experts have discussed with government officials ways to eliminate the dollar from export operations. Economy minister Alexei Ulyukaev, has called on Russian energy companies to be 'braver in signing contracts in rubles and the currencies of the partner-countries'.

There has been talk of introducing a 'currency switch executive order', whereby companies could be compelled to transact a percentage of their operations in, say, Russian rubles or Chinese yuans.

Rosneft has concluded a 'goods-for-oil' swap with Iran which provides 500,000 barrels of Iranian oil per day to sell on global markets. And Gazprom's recent US$400 billion gas deal with China is viewed by both sides as a way of moving away from US dollar domination.

What will save the greenback for some time to come is that the alternatives are not good. A functioning global reserve currency has to be both liquid and 'deep', i.e. it must be possible to sell quickly and in large amounts without significant impact on price. Despite the gross mismanagement of the US economy, the US dollar still fits that bill. The euro has fallen far short of initial grand visions, but remains a second best. Neither sterling nor yen come close.

Stefan Hedlund *is Professor and Research Director at the Centre for Russian and Eurasian Studies, at Uppsala University, Sweden. He trained as an economist and has specialised in Russian …*

Articles by: **Stefan Hedlund**