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The Dollar Centric Financial System and the Conflict in Ukraine

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The war in Ukraine could be seen as symptom of a historical phase characterized by the decline of the international monetary system centered around the dollar, which has increasingly proven to be fragile and prone to structural collapses. In this contribution, we will briefly reconstruct the functioning of the international financial system to reflect on the prospects of its decline and the emergence of rival monetary circuits, which are yet to be defined.

1. The monetary system after Bretton Woods

Since the Bretton Woods agreements, the United States has ensured the role of the dollar as the international currency, albeit within a framework of multilateral agreements based on fixed exchange rates with control over financial capital movements. The centrality of the dollar and its stability as an international store of value were guaranteed by its convertibility into gold, a characteristic that created increasing difficulties over the course of two decades. As the foreign exchange market between currencies was restored and the global economy recovered from the destruction of the war, the quantity of gold available and extractable on a global scale proved insufficient to meet the demand for international liquidity and simultaneously guarantee convertibility with the dollar at the fixed parity. In terms of political consequences, in the 1960s, the United States faced the dilemma of whether to defend the convertibility between the dollar and gold agreed upon at Bretton Woods or to pursue an internal objective of economic growth. The first objective had to be attained at the cost of restrictive fiscal policy that would have also resulted in a scarcity of dollars as international reserves in the face of increasing demand. The second one required accommodating foreign demand for dollars at the risk of jeopardizing the stability and convertibility of the dollar. As Triffin highlighted, at the root of these difficulties was the choice to use a national currency as an international reserve; a choice strongly advocated by the United States, which fought at Bretton Woods to assign the dollar a role as the gravitational centre of the entire international monetary system (Triffin, 1961).

With the breakdown of the agreements in 1971, the United States continued to pursue a policy of power, but in a context of marked unilateralism aimed at its own geopolitical and economic objectives. The post-Bretton Woods international monetary system, freed from the fetish of the gold standard, was built upon the availability of Treasury bills, which were not extracted from mines scattered around the world (including mainly in the territory of the rival superpower, the Soviet Union), but conveniently issued by the US Treasury. The post-Bretton Woods monetary system, under pressure from the financial sector and the monetarist economic theory, was characterized from the outset by flexible exchange rates and, increasingly, by a progressive abandonment of control over international capital movements. It also became inextricably intertwined with the supply of fossil energy sources, particularly oil, which became a particularly expensive and scarce resource since 1973 (Hutton, 2002).

The mechanism on which the dollar-centered monetary system was based and its relationship with financial and economic crises are often subject to ambiguous interpretations, which are sometimes unwittingly influenced by ideas of a theoretical orthodoxy built upon a conception of money as an element of nature. Paradoxically, these ideas gained strength precisely after the abandonment of the practice of anchoring currencies to gold.

One issue that needs to be clarified once and for all is that of the so-called financing of the US trade deficits. Many politicians and economists have interpreted the international monetary system in the light of the loanable funds theory, according to which a subject who wants to spend must attract funds primarily saved by another subject. This view assumes implicitly that the financial funds available are the liquid equivalent of a limited real wealth accumulated. Internationally, the loanable funds theory has often led to the misconception that the United States (as net importer) can "finance" the current account deficit only because it attracts funds, understood as net savings (or current account surplus) produced by other countries (like China).

Both the tween deficit and the saving glut views on the US external deficit can be seen as derived from a loanable funds assumption. The tween deficit view derives the US external deficit from the US government deficit, which drains limited financial resources out the private sectors of the economy; the combined effect of interest rate and exchange rate adjustment transfer the drain of resources into the external deficit (Salvatore, 2006).[1] The saving glut view, on the contrary, blames the rest of the world excess saving over investment for generating US external deficit (Bernanke, 2005). Excess saving of foreigners, in turn, can be seen as either driven by attractive rates of return for investments in US, or by export led strategies pursued by devaluating local currencies.

The idea that saving from the rest of the world is a precondition for US spending has always been part of the common sense even outside the academia. President Nixon, to justify the abandonment of the Bretton Woods system, stated in front of the German parliament that the US needed to appropriate 80 percent of the current account surplus of the industrialized West for its strategic military purposes. Seen from a loanable funds perspective, this statement could be understood as if the United States (the Western superpower!) really needed to raise funds from a limited stock of accumulated savings from other countries in order to "finance" their strategic and military expenses.

That is not how it works. The current account deficit of the United States is not the result of credit in dollars provided by another country but rather a credit in dollars issued by the only institutions authorized to issue dollars, namely the US national banking system. The US current account deficit exists not because other countries lend their financial savings to the United States but because they demand dollars as reserves or private portfolios or means of payments (Wray, 2019).

Let's also add a consideration that is even less consolidated in the minds of those who reason about international economics: as emphasized by post-Keynesian economic literature, within a well-integrated international monetary system, a current account deficit of any country – not just the superpower that

[1] An alternative model of tween deficits, which is not built on the loanable fund theory, is developed by Godley and Cripps (1983) under the New Cambridge post-Keynesian tradition. Its explanation of the causes of tween deficits is rather reversed, the tween deficit being not pulled by fiscal deficit, but by foreign demand for domestically produced goods. The model implies that trade restrictions are valid and possibly better alternative to fiscal austerity to reduce both fiscal and external deficits. The model, however, is heavily dependent upon the very restrictive assumptions that domestic investment is endogenously determined by the income level and that domestic private saving is, in normal conditions, equal to the investment. (see Lavoie, 2016, pp. 515-16).

provides the most widely accepted reserve currency – is typically accommodated by endogenous variations in financial positions between commercial banks of trade partners.

This circumstance contrasts with the more commonly held belief that, in order to prevent a deterioration of the balance of payments, a current account deficit requires active economic policies to attract new capital inflows from abroad, such as raising domestic interest rates or reducing taxes. In the absence of these active policies, a depreciation of the exchange rate will be inevitable. This latter conception is typical of the Mundell-Fleming model incorporated in basic macroeconomics textbooks and is, once again, an expression of the loanable funds theory, which posits that finance, even on an international scale, is a quantity available in limited supply, and countries compete to attract it.

On the contrary, post-Keynesian literature emphasizes that the availability of financial funds is elastic and adapts to demand, both on a national and international scale. Consequently, in the face of a current account deficit, thanks to interbank credit lines, the balance of payments is brought into equilibrium even in the absence of spontaneous capital movements of the non-banking sector, and without any necessary consequences for the exchange rate, the interest rate, or the change in foreign currency official reserves.[2]

The prevailing idea that dominates the vast majority of economic thought and public discourse, which suggests the need to "attract" foreign savings to "finance" a current account deficit and avoid the depreciation of the national currency, stems from a theoretical conception of the banks not as institutions empowered to create money out of thin air, but as mere intermediaries between savers and spenders.

2. Predatory Finance and its Institutional Protection

Returning to Nixon's statement mentioned above, if the centrality of the dollar in the international monetary system is not functional for the appropriation of global savings, then what is its purpose? To answer this, one only needs to consider that the imposition of the dollar as the international unit of account and store of value has been accompanied by the growth and consolidation of the US banking and financial system as the headquarter of the entire global capitalist system. This construction has been realized through three strategic lines that are worth summarizing.

Firstly, the political and military supremacy of the United States ensured that not only oil and internationally traded goods were denominated in dollars but also that the liquid funds created by the US banking system and accumulated by oil-producing countries flowed back to US banks in the form of deposits (petrodollars). This ensured that the circuit of international money would begin, flow, and regenerate within the US banking system.

Secondly, through an aggressive policy of international credit and the removal of barriers to the free movement of financial capital, the US expanded the pool of its debtors to include governments of emerging countries. As a result, US guaranteed a source of income to its banking system through its political and military power. The US banking system was backed by institutions such as the International Monetary Fund (IMF) and the World Bank, which progressively transformed from multilateral

[2] Interbank credit, created and contracted with an accommodating function, is recorded under the "other investments" category of the balance of payments and constitutes one of the components of the financial account, along with foreign direct investments, portfolio investments, and changes in the stock of official reserves. See Lavoie (2014), pp. 460-2.

institutions, in the spirit of the Bretton Woods agreements, into tools of the US Treasury. In fact, if a debtor country declared insolvency (the first case being Mexico in 1981), the IMF intervened with rescue measures consisting of providing dollars to the failed governments in exchange for austerity measures. With IMF dollars, the debtors repaid US banks, while austerity measures condemned them to human sacrifice and structural dependence. The rescue measures were designed to save the US financial system from the insolvency of its debtors. More generally, countries that needed dollars to import goods not available domestically were destined to pay for their foreign debt service with persistent trade surpluses and with a domestic demand chronically undersized compared to their productive capacity. This provides a more accurate description of the surplus appropriation mentioned by Nixon.

Finally, the debt-based monetary system did not only involve developing countries but also spread within wealthy and industrialized nations. Starting with the deregulation initiated by the governments of Reagan and Thatcher in the 1980s, the liberalization of capital movements led to a progressive transformation of the financial system from one regulated and primarily geared towards supporting the productive process to one that is mostly speculative, predatory, and focused on short-term returns. The growth of debt in industrialized countries was pursued through increasing income inequality, a development model that relied on the growth of both private debt (to cover expenses that disposable income could not meet) and public debt (to compensate for reduced tax revenues), as well as debt from foreign buyers (in countries like Germany, where low wage dynamics coincided with containment of domestic demand).[3]

The financial architecture that ensured the centrality of the dollar, long before being shaken by the war in Ukraine, has progressively become more fragile and subject to structural collapses. The financial crises that initially manifested as peripheral debt crises in developing countries eventually affected even the major Western powers. When the first stock market crisis occurred in the era of deregulation in 1987, the level of private sector debt in globalized economies was already in “dangerous territory” (Keen, 2009). Central banks, in order to avoid economic depression, price deflation, and a generalized debt crisis, saved the financial system through liquidity injections and low interest rates. This method was increasingly applied in the following decades, with significant accelerations occurring during the global financial crisis of 2007-08 and the pandemic crisis of 2020-21.

On no occasion did economic policy commit to clean up the enormous private indebtedness generated by the financialization of the economy, especially for the benefit of the most vulnerable social groups. However, proposals in this regard have not been lacking, such as the proposal of "quantitative easing for the people" (Jourdan, 2015) or simply the absorption of private debt through public intervention emancipated from the complex of inferiority derived from the ideology of balanced budgets (Mitchell, 2010). As several heterodox scholars have emphasized, currency, both national and international, is the institution through which a society builds a political compromise between conflicting interests, namely debtors and creditors of different backgrounds and social functions (Ingham, 2006). We should point out, therefore, that the global governance of currency, overseen by central banks, is still entirely imbalanced and entrenched in defense of the interests and bargaining power of creditors. It is increasingly implausible, in fact, to interpret the aforementioned series of bailouts as a mere compulsion to repeat driven by the absence of alternative strategies. It is to be believed that it is rather a genuine political strategy aimed at safeguarding the US-centered financial system built on debt and dependence. Desai and Hudson (2021), not without reason, define the Western power bloc centered around the dollar as a creditocracy.

[3] Palma (2009); Onaran et al. (2011).

It is worth noting, in this regard, how the usual epithet of the world's “largest debtor” attributed to the United States, in reference to its negative net foreign position, tends to overshadow its role of headquarter of the international financial system. Labeling a country that has been issuing the international reserve currency since the post-World War II era as a debtor is misleading, just as considering the liquidity injections of a central bank as debt. As a matter of fact, repaying foreign debt in dollars does not require the US to pay any real cost. As we have seen, claiming that the United States can "finance" excess demand thanks to foreign credit is as misleading as asserting that banks extend credit only as a result of prioritized deposit collection, or that governments spend only as a result of tax collection (or anticipating future taxes). The political and military power of the United States is not so much aimed at enabling it to “borrow” from abroad but rather at preserving the centrality of its credit system as the headquarters of global capital.

3. War in Ukraine and global finance

Let us now turn to the signals of changes that are emerging with the war in Ukraine. The field of analysis regarding the relation of the war with the breakdown of unipolarism and its transformation into a multipolar world is certainly vast and complex. Here we limit the analysis some relevant aspects connected to the centrality of the dollar in the international monetary system.

If we examine the 25-year period prior to 2014, we can observe that the changes in the current account of the United States closely align with variations in the official reserves held by central banks worldwide. Since 2014, there has been a significant reduction in global dollar reserves. This has not resulted in a decrease in the US external deficit but rather a transfer of US assets to foreign private entities. The decline in the accumulation of dollar reserves by central banks can be attributed to different factors. Firstly, there has been a decrease in oil prices and a reduced dependency of the US on oil from exporting countries, which has caused a decline in dollar reserves held by nations reliant on oil exports. Secondly, the Eurozone countries have progressively increased their foreign surplus or reduced their deficit due to self-imposed austerity policies in the decade following the 2007-08 crisis. This has led to a relative increase in the acquisition of US securities by private entities within the Eurozone. Thirdly, in the Asian region, although the current account surplus of Asian countries has remained stable, central banks began to halt the accumulation of dollar reserves around 2014 and started to decrease them from 2015 onwards. China, being the largest economy, played a significant role in driving these changes. In many Asian countries, institutional investors, such as life insurers and pension funds, seeking higher yields in a world of quantitative easing in Europe and strict fiscal policies in several surplus economies, have displaced central banks as the major buyers of U.S. government bonds (Setser, 2018).

From the perspective of the United States, the rising concentration of dollar-denominated assets into the hands of private entities in Asia can only be seen as a risk. On the one hand, the US are in front of a decline in consensus on their role as issuers of international currency, and on the other hand, they witness the rise of alternative hubs in global private finance that rival the dominance of the U.S. financial system. Therefore, the protectionist retreat of the United States that we have witnessed in recent years, first under Trump and subsequently under Biden, particularly in the context of the war in Ukraine, should not be interpreted as the result of unsustainable foreign debt or as a reaction to the acquisition of US stocks by capital accumulated by net creditor countries. Rather, it is the reaction to the gradual emancipation of new economic, industrial, and commercial powers, primarily China, from the hegemony of the dollar. The progressive reduction of the stock of US Treasury bills held as reserves by the Chinese central bank is not an adjustment of financially oversized quantities, but a deliberate act that has made dollar assets politically abundant. This has triggered the reallocation of financial assets that has

endangered the centralization of capital in American hands, fueling US protectionist measures, or friend shoring. As previously underlined, placing excessive emphasis on the net (rather than gross) foreign position of the United States and simplifying geopolitical conflicts as a mere struggle between a (net) "debtor" superpower and its creditors may lead to distorted perspectives or a misinterpretation of causes and effects.

In this described scenario, the conflict in Ukraine, on the one hand, serves the purpose of furthering the US strategy to transition from a role as a global advocate for free trade to that of a protectionist leader of a smaller group of countries, urging allies to sever trade ties with non-allies, while being surrounded by continuously expanding emerging economies. On the other hand, the war has set in motion a sequence of events that could potentially undermine US hegemony over international financial markets.

By freezing $630 billion of Russian reserves and assets abroad and imposing an embargo on Russia's access to the SWIFT international payment system in March 2022, the US has challenged a fundamental assumption that underpinned international trust in the dollar since the conclusion of World War II: the prompt fungibility of dollar reserves. As the international community realizes that the superpower has no intention of ensuring the solvency of its highly liquid obligations, which traditionally hold a top position in the hierarchy of all the financial instruments generated in the extensive realm of international finance, the inevitable result is a loss of trust, gradually unfolding at least among certain parts of the world.

Following this sanction measure, Russia has responded by requesting to be paid in rubles for the gas it supplies. The purpose is not so much to support the exchange rate, an objective that could have been achieved by continuing to sell fossil energy sources in dollars, but rather to escape the dominance of the dollar. More or less intentionally, Russia has denied the dollar the role of international unit of account, a function typically associated with a legitimate currency. It is worth recalling that the dollar as an international unit of account was safeguarded by an agreement dating back to the oil crises of the 1970s between the United States and Saudi Arabia, in which the former secured that oil prices would be denominated in dollars (thus anyone purchasing oil would need to acquire dollars), while the latter obtained military protection. The Russian decision breaks this tradition and, by rejecting the sovereignty of the dollar, asserts its own power policy. While it is true that Russia's industrial capacity does not match that of the United States or China, it is equally true that Russia remains a country capable of providing its allies with both energy resources and military protection.

The fracture sets in motion the entire world system, which experiences a swarm of seismic shocks, as many countries seek to reorganize and redefine their strategic and commercial alliances. Saudi Arabia agrees to sell oil to China in exchange for Yuan, with which it purchases Chinese goods or holds currency reserves (ZeroHedge, 2022). India takes distances from the US sphere of influence by casting a non-aligned vote at the UN and enters into agreements with Russia to buy Russian weapons, paying for them in rupees, a currency that Russia will then use as reserves by purchasing Indian securities (Goldman, 2022). The group of BRICS countries gains an aura as a potential alternative geopolitical bloc to the Atlantic alliance, not limited to the Eurasian territory. The recent requests for membership (Argentina, Iran, Algeria) reveal how the group of countries representing a third of the world's landmass (thus wielding enormous market power over natural resources and fossil energy sources), along with 40% of the global population and "only" 25% of the world's GDP, has become an attraction for any country wishing to attempt to break free from dependence on the US "creditocratic" system. Even Saudi Arabia, as just emphasized, is not immune to the temptation.

Regardless of the fact that the outcome of these reorientations is still unpredictable, it seems possible to establish that the war in Ukraine has provided an accelerating push to various technical trials of

detachment from the monetary, financial, and commercial circuit centered around the dollar (Sullivan, 2023). At present, in the potential new bloc revolving around the BRICS countries, there are discussions to establish an international currency anchored to a basket of national currencies (Silk Road Briefing, 2023). However, it cannot be ruled out that, at least temporarily, the flight from the dollar may materialize in the anchoring of national currencies, primarily the Yuan, to natural resources (Rhan, 20232). The race for natural resource procurement (for example, China is stockpiling the gas that Russia no longer sells to Europe) can be explained strategically as a competition between rival powers to secure potential production capacity. From a monetary perspective, it can be seen as a regression towards the fetishization of commodity money, characteristic of a historical phase in which a social and political system represented by an abstract unit of account, based on universal trust and legitimacy, has not yet fully emerged. After denaturalizing money fifty years ago with the tumultuous abandonment of the Bretton Woods dollar-gold exchange standard and the creation of a global fiat currency, we may now witness its renaturalization, with rival currencies being anchored to natural resources.

One last consideration can be made regarding the attempts to build an alternative international credit circuit - or rather, different credit circuits - which are primarily aimed at non-financial trade and investment. The initiative to return to an industrial capitalism serving production, consumption, trade, and widespread well-being, while facing significant political challenges in societies that have been the cradle of principles such as representative democracy, the rule of law, and the welfare state, paradoxically seems more attainable in countries characterized by despotic regimes or unstable democracies, which are not particularly attractive to the Western world. If successful, the reestablishment of finance serving entrepreneurship in a part of the world would leave Western countries alone in confronting their hypertrophic, speculative finance disconnected from the real economy, with its inherent inequalities and debt traps, and with progressively limited access to the productive capacity of countries outside the dollar area.

To what extent can the institutions of the Western countries afford to protect their rentiers without jeopardizing the resilience and stability of the social and political fabric, as well as the legitimacy of a system they proudly continue to call democratic?

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