Currency Statecraft and De-dollarization: A Review Article

Francesco Romagnoli
Department of Political and Social Science - Bocconi University
https://orcid.org/0009-0001-3186-3330

Abstract

This article explores the dynamics of international currency competition and de-dollarization, focusing on the current dominance of the US dollar and potential challenges from the Chinese renminbi and BRICS countries. It reviews recent literature on currency statecraft, the political economy of the renminbi, and the capacity of BRICS nations to foster de-dollarization. The studies reviewed suggest that while no currency or coalition poses an imminent threat to the US dollar's dominance, the geopolitical landscape and countries' foreign policy ambitions play crucial roles in shaping future monetary relations. This review highlights the importance of geopolitics in understanding the complex interplay of international currencies and states' strategic responses.

Introduction

The functioning of the global financial system is strictly dependent on its principal international currency. Since the post-war era, the US dollar has been the undisputed dominant currency, net of the short-lived challenges emerging from the Japanese yen in the 1970s, the German mark in the 1980s and the euro in the early 2000s. Nevertheless, following the Great Financial Crisis, scholars started questioning the US dollar dominance (Helleiner, 2014; Helleiner and Kirshner, 2009). In the same way as the US dollar displaced the previous dominant international currency, the British pound, its incumbent position may not be permanent. As a matter of fact, one of the most debated questions in the international politics of money revolves around whether a new international currency will ever emerge to challenge the position of the US Dollar. Past scholarship has framed currency competition as a battle of giants, anticipating that the dollar replacement could only occur from US-comparable economies in terms of size and volume of international transactions (Arslanalp, Eichengreen, and Simpson-Bell, 2022). The Chinese renminbi started raising international attention as a credible candidate in the early 2010s (Subacchi, 2017) with increasingly comparable figures to US in terms of aggregate GDP and volume of international transactions. However, by mid-2010s, the ascent of the renminbi had slowed. Meanwhile, other non-traditional currencies started to emerge as international reserves (such as the Australian dollar, Canadian dollar, Korean won, Singapore dollar, and Swedish krona), despite not having economic traits typically associated with traditional reserve-currency issuers (Arslanalp, Eichengreen, and Simpson-Bell, 2022). To overcome economic limits, a collective effort is being made in the BRICS (Brazil, Russia, India, China, and South Africa) countries, considered as the next potential candidates to reduce US dollar's global influence.

For a comprehensive understanding of whether and how a new international currency can replace the US dollar dominance, this article will focus on three recently published books. (Cohen, 2019)'s *Currency Statecraft* proposes a theory of state management of the currency instrument when it gains international reputation, with the aim of assessing the present and future of monetary rivalry thorough the complexities of currency statecrafts. (Chey, 2022)'s *The International Political Economy of the Renminbi* takes the reverse view: it develops the concept of reactive currency statecraft as a framework to analyze state responses to the emergence of a new international currency, with a focus on the renminbi. The novelty of the work stems from the analysis of each state's reaction to renminbi internationalization considering its foreign policy vis-à-vis China and its broader international currency policies. BRICS countries also represent a potential challenge to the international system based on the US dollar. The article will include (Liu and Papa, 2022)'s *Can BRICS De-dollarize the Global Financial System?* Considerations on the potential evolution of BRICS as a de-dollarization coalition.

The joint analysis of this scholarship allows a broader evaluation of de-dollarization and international currency competition taking different perspectives. This article reviews the dynamics of the strategic use of international currencies and states' reactions to such use, moving beyond country-specific approaches and assessing schemes to approach novel international monetary developments. All the studies under review agree that no currency, or coalition of currencies, represents, to date, a concrete threat for the US dollar dominance in the foreseeable future. The concreteness of this challenge depends on states' foreign policy goals and ambition, and on their willingness to take on a direct confrontation vis-à-vis the US dominance. The key take-home from this review is that geopolitics is a key determinant to predict the outcomes of monetary rivalry and international currency competition.

Currency statecraft, reactive currency statecraft, and de-dollarization

Currency statecraft is "the strategic management of a country's money to advance political objectives in international affairs" (Cohen, 2019, p. 31). This definition stems from currency power, the idea that not only currency internationalization, the process by which a state's national currency comes to be used by market actors outside the issuer country, is a consequence of state power, but it also determines it, adding to the country's power resources (Cohen, 2015). Departing from this concept, Cohen aims to challenge conventional wisdom – rooted in the realist tradition in international relations – which assumes that an international currency automatically translates into a country's key to leverage this power. To this view, Currency Statecraft opposes a more complex decision-making process leading states to the use (or non-use) of their monetary muscle. In other words, while currency power explains how currency internationalization enhances the issuing state's material capabilities, currency statecraft focuses the attention to what issuing states decide to do or not to do with those capabilities once they obtain them. Understanding currency statecraft involves power, competition, and the subsequent conflict of interests among states that characterizes global politics. With this framework, Cohen (2019) assesses the present and future of monetary rivalry thorough the complexities of currency statecraft, for which the emerging confrontation between the US dollar and the Chinese yuan represents the ideal testing ground.

Chey's (2022) novel book complements this view with a review of foreign states' reactions to the rise of the renminbi as a new international currency, introducing the concept of *reactive* currency statecraft. This defines as a "state's deliberate response to the internationalization of a foreign currency in order to achieve its policy goals, including its foreign policy goals vis-à-vis the currency's issuer as well as its policy goals related to international currencies overall" (Chey, 2022, p. 11). Indeed, previous research on renminbi's international expansion had focused solely on the domestic dimension of the "middle-kingdom"(Subacchi, 2017). With its focus on foreign responses, Chey's (2022) analysis adopts a symmetrical approach to Cohen's (2019) framework, with the exception that reactive currency statecraft is a theory forcedly grounded on the experience of a single new international currency, the renminbi.

In the meantime, a growing number of countries have intensified their efforts to decrease their dependence on the dollar through de-dollarization, in backlash against the recent increased weaponization of the US currency (Chey, 2022). Liu and Papa (2022) indeed focus on the collective efforts of the BRICS to investigate whether this group of countries can de-dollarize the US-led global financial system. They develop a framework that explains how a rising power coalition can pursue de-dollarization to challenge the dollar hegemony, providing a complement to the concepts of currency statecraft and reactive currency statecraft.

International currency lifecycle and policy options

To understand a country's currency statecraft, Cohen's theory suggests looking closely into the lifecycle of international currencies. Indeed, the strategic management of currency power evolves along with the international appeal of moneys, and each different stage of internationalization – youth, maturity, and decline – corresponds to three different policy options: statecraft can proactively favour or oppose internationalization, while states can also decline to take any action. This makes up for a total of nine policy options during a currency's life cycle. Currencies in their youth can promote, prevent, or permit internationalization, while in their maturity phase the choice is among exploitation, evasion, or enjoyment of their status. At the twilight of their international appeal, currencies face the options to resist, reinforce or relax. This framework builds on historical records from the small sample of privileged currencies that gained international status from Bretton Woods until today. Based on the historical records, only a handful of governments have ever had to make policy choices about the management of their currency power. This is the main puzzle resulting from the historical analysis of currency statecraft, and two questions guide the analysis of the experience of different currencies at each stage of internationalization: what are the determinants of a country's policy choice, and what are the factors determining its effectiveness? Cohen claims that what really drives policy choices at each stage of internationalization is geopolitical ambition: the way a nation views itself in relation to others. This is the reason why some international currencies in their youth (West Germany and Japan) or maturity (the "top-tier club") decided not to further foster internationalization but opted, respectively, for prevention and enjoyment.

Both Cohen (2019) and Chey (2022) agree that the effectiveness in translating a country's aspirations into success is determined by the reactions of currency users and competing governments, since currency statecraft, and reactions to it, is a matter of competition among moneys. This is why the analysis of how foreign states have responded to the renminbi's internationalization is of great importance. Chey's (2022) comparative analysis of four country responses, namely the United Kingdom, Japan, South Korea, and the United States, highlighted that all such states have deliberately used their policies related to renminbi as means of achieving their economic and foreign policy goals associated with China. Resulting from in-depth qualitative research and extensive interviews with government officials, financial institutions, non-financial corporations, and local experts, reactive statecraft involves three alternative strategies vis-à-vis a new international currency: accommodation, hindrance, and non-involvement. Unsurprisingly, the leading factors in determining the reaction strategies include the weighting of the chief latent benefits that a country may be able to obtain and the costs that it may have to bear from renminbi internationalization. This assessment differs among countries based on their unique domestic and international situations, aligning with their broader foreign policy objectives concerning China.

Within this context of global currency rivalry and strategic state actions, it's somewhat unexpected that, despite the geopolitical tensions between China and key nations like the United States and Japan, and the anticipated rivalry among the renminbi, the dollar, and the yen, Chey (2022) asserts that none of these four countries have actively hindered the renminbi's global integration. Instead, the typical reactions have been those of accommodation in the United Kingdom, Japan, and Korea, while the United States has also adopted supportive policies, though briefly. All four nations aim to derive certain benefits from their foreign policy strategies towards China by supporting the renminbi's global rise. Specifically, the economic goals of Korea and the UK focus on fostering growth through enhanced economic links with China's expanding economy, whereas Japan and the US have pursued goals that are more political, seeking to strengthen their diplomatic ties with China. Additionally, Korea has shown a desire to enhance financial stability by diversifying its portfolio of international currencies, further driving its support for the renminbi's international use. Overall, evidence from reactive currency statecrafts further confirms Cohen's statement that global politics has been significantly involved during the renminbi's rising internationalization.

Global politics influences significantly also the broader dynamics of de-dollarization. Liu and Papa (2022) emphasize the importance of examining the BRICS countries' de-dollarization activities, noting that these efforts have direct implications for the national security of the United States. They point out that the US depends on the dominant status of the dollar to effectively implement economic sanctions and engage in coercive economic statecraft against its adversaries (Liu and Papa, 2022, p. 2). The recent successes of the BRICS in financial collaboration, including the creation of the New Development Bank (NDB), the Contingent Reserve Arrangement (CRA), and other financial coordination frameworks, warrant closer scrutiny within the evolving politics of global monetary relations. Within this framework, Liu and Papa identify two primary risk mitigation approaches that emerging powers might adopt to lessen their vulnerability to the dollar's dominant influence: adopting independent ("go-it-alone") strategies and pushing for systemic reforms ("reform-the-status-quo"). Independent de-dollarization efforts focus on creating and managing new non-dollar-based institutions and market mechanisms. On the other hand, reformative efforts involve collaborative actions to change the rules of the existing financial system through negotiations with established powers, aiming to weaken the US dollar dominance. These strategies, rooted in risk management practices, allow coalitions of rising powers like the BRICS to advance de-dollarization to mitigate risks associated with reliance on the US dollar and US-imposed sanctions. This is an aspect that Liu and Papa stress in their work, which results in almost overly enthusiasm to the reader. Evidence indicates that BRICS have reached agreements and are committed to advancing the use of their local currencies in international transactions and to establishing a non-dollar-centric global financial infrastructure by pursuing both strategies simultaneously. For instance, the launch of NDB aimed at de-dollarizing finance development, and the BRICS are planning to introduce a common payment system that could support a BRICS digital currency, further diversifying away from the dollar in global financial infrastructure.

Nevertheless, many de-dollarization efforts are occurring primarily at the level of individual country within the BRICS. For example, China has launched the yuan-denominated oil futures contract to move away from the dollar in global oil markets, and both China and Russia have developed their own cross-border messaging systems. Yet, complete detachment from the US dollar-led system remains elusive for the BRICS due to geopolitical factors. There is a lack of a common stance and urgency among BRICS members regarding de-dollarization, which explains why these initiatives are more frequent at the national rather than the group level and have not yet achieved the scale necessary to change the global financial system comprehensively. Indeed, some BRICS countries maintain closer ties with the United States than with their fellow members, and countries like Brazil and South Africa are less affected by US sanctions and more integrated into the dollar-based system than others. While all BRICS nations are keen to lessen their dependency on the US dollar, not all are prepared to fully break ties with the US-led global financial system.

Empirical evidence of currency statecraft and reactions to it

Cohen's (2019) framework sees the currency statecraft strategy choice at each stage independent from decisions taken in every previous phase. A currency in its decline can indeed take a turn and become neutral, while it decided to favour currency internationalization at its maturity. Being currency statecraft an evolving process, it is all but unusual for a currency to change its policy response even within the same stage of internationalization – as for the case of Japan yen in its youth phase of internationalization. In this phase, it is the relative weight that nations attribute to their geopolitical ambition that drives this choice. Promotion is generally associated with high emphasis on international ambition, while prevention is more attractive for countries whose geopolitical ambition is self-limited and that shifts emphasis on domestic stabilization. This is consistent with China's determined long march towards a global status for its renminbi, while West Germany and Japan (before 1990) prevented their international promotion. The case of Japan is insightful as its position reverted from opposition to promotion the moment Japan sought currency internationalization to escape economic stagnation following the 1989 bubble bust. Furthermore, geopolitical factors came into play, as promotion policies were a means to retain Japan's long-standing economic leadership in East Asia, threatened by the Chinese new economic reforms at the end of the 1970s. In Cohen's theory, Japan is also a case for understanding why currency strategies do not always convert into effective results (utility question). In the youth phase, indeed, the effectiveness of policy strategy seems to depend on whether there is alignment or divergence between the preferences of a currency's users and issuing authority. The Japanese turn towards a promotion strategy was wrong in timing, as at that point the market was no longer interested in the yen after years of prevention policies.

During this initial phase, the drive for economic expansion through enhanced economic connections with the growing Chinese market has strongly motivated policies that internationally support the use of the renminbi. This indicates that extensive pre-existing economic integration with China is not essential for countries seeking to gain growth advantages through supportive reactive policies towards the international use of the Chinese yuan. The example of the UK illustrates that a nation can implement such policies as an instrument to strengthen its economic relations with China, being among the first to proactively embrace accommodating responses. From the early 2010s, as the renminbi started to emerge on the global stage, the British government introduced several policy measures to position London as the Western hub for renminbi transactions. However, growth in the UK has largely stalled, mirroring the broader global slowdown in renminbi internationalization since the mid-

2010s. This underscores that while political influences significantly affect the global utilization of the renminbi, they are not able to completely offset market dynamics: both states and markets shaped renminbi's global growth. Furthermore, examples from Japan and the US show that even China's major geopolitical adversaries might engage in accommodating reactive statecraft as strategic means to enhance their diplomatic ties with China. Concerning the potential security downsides of the renminbi's rise, its potential to augment Chinese influence has rarely played any role in the reactive policies of the United Kingdom, Japan, or South Korea. Nor have these nations significantly considered the risk that the internationalization of the renminbi might impede their currencies to maintain a global status or experience the same process.

At the stage of maturity, whether promoted or not, currencies have become internationalized, and issuing countries must decide their strategy responses. From the analysis of the currencies that decided between exploitation, evasion, or enjoyment, the main driver is still represented by the national identity and the geopolitical ambition. Therefore, for the top-tier club, among which Cohen includes the British Pound, the Swiss Franc, and the Canadian and Australian dollars, it was a natural choice to enjoy their international appeal and leave the full privilege to the US dollar. In the context of maturity, Cohen presents the US as – indeed – the clearest example of the exploitation option. In the case of the US, the policy strategy seems to have always remained what we would expect from a currency power at the top of the currency pyramid: exploitation. Proactive policy for the US has usually meant to use the leverage of currency power, not to abjure it. In the context of the US monetary power exploitation, the main question regards what can limit the exploitation effectiveness for a currency superpower in its maturity. The distinction here is between direct and indirect power. The second, for the US, refers to its ability to finance external imbalances in its own currency, better known as the "exorbitant privilege" (Eichengreen, 2011). This privilege potentially has its limitations in financial solvency and in the rise of new currency alternatives that might overthrow the US leadership. Nevertheless, Cohen's conclusion is that for the US dollar, neither of the two factors represents a concrete threat to its position while in its maturity. Direct power is instead a policy tool to achieve foreign policy goals. This power is limited domestically in the form of political capacity, which reflects the practical ability of a government to formulate, implement and enforce formal policy decisions (Cohen, 2019, p. 125). For example, the Congress in the US, with its veto power, represents a major domestic veto player for the US' ability to exploit its currency power, especially in comparison to Chinese central decision-making process. This aspect makes the US currency statecraft more bounded to limits compared to China's.

Sooner or later, all international currencies will reach a tipping point and enter their declining phase. The challenge becomes how to cope with decline. At this stage, countries can decide to resist decline, reinforce it, or, rather, relax and do nothing. The British pound and the Japanese yen are the two most representative cases for this phase. Japan quickly pursued a relaxation policy: as its 1990s U-turn strategy to revive the currency's internationalization proved ineffective, Japan quickly entered in a phase of decline during which it has always remained neutral. Differently, it took Britain three decades to shift from a currency statecraft of resistance to a reinforcement one. The different lags needed for Japan make it clear how geopolitical ambition – in this case past ambition – plays a key role in the phase of decline as much as in maturity and youth. This element is important for the exploration of the future of currency statecraft, as sooner or later the US dollar will enter its declining phase either because of a truly attractive alternative, maybe the Chinese renminbi, or because of its own policy errors. The open question is how the US will cope with a declining US dollar.

Conclusion: US overconfidence and credible threats

In the contemporary era, direct collisions between states have been rare. One explanation relies on the lack of geopolitical ambition between the countries that issue international currencies. According to this view, China represents an exception, as for the first time the US dollar faces the rivalry of a nation that is neither a friend nor an ally: China has clearly no compunction about challenging the US global leadership. And yet, evidence from the initial phase of renminbi's internationalization shows that the overall reaction from other issuing countries, including the US, has been accommodative. It is possible to draw different considerations based on the scholarship reviewed in this article.

First, while accommodation has been the dominant form of reactive currency statecraft in response to renminbi's internationalization, the motivation driving the US' response might have differed. The US tolerance of the renminbi's growing international use stemmed from the strong confidence that the renminbi would be unable to threaten the dollar's predominance soon. It is indeed a shared opinion in this scholarship that China still faces structural challenges to be regarded as a global contender to the US dollar. China still lacks some of the capabilities that help make money competitive at the international level, such as its authoritarian government, its military build-up, and a primitive-quality financial sector. The limits to Chinese monetary muscle seem to be therefore rooted in its domestic constraints. If China decided to fully address the deficiencies of its currency, it will be necessary to adopt direct reforms at the heart of the Communist Party's distinctive model of political and economic management. Chinese authorities are aware of this and, therefore, are proceeding with gradualism.

Furthermore, what really drives the success of a new international currency is the interest of countries in moving away from the incumbent international currency, in this case the US dollar. For the case of the Chinese renminbi as well as for the BRICS, existing global financial realities are unlikely to be altered in the near term. Moreover, the potential benefits of de-dollarization come at a deterrence cost: breaking away from the existing dollar-based global system and market structure is analogous to self-imposed isolation from the existing system. Countries like BRICS would face significant separation costs, with the most immediate ones being increased costs of cross border transactions, more expensive capital raising in the dollar-based global markets, and reduced competitiveness of their firms in foreign markets due to a shortage of dollar funding. Whether the BRICS governments could credibly enforce de-dollarization initiatives at the firm level, especially on firms operating in foreign territories where the US dollar is the dominant and preferred currency, is questionable. In such scenarios, a collision between the US and the next international currencies can indeed occur. The outcome from the confrontation between the US and China is unlikely to be a bipolar world but rather a multipolar one. According to some, the monetary counterpart of a multipolar world will be a leaderless currency system: several moneys competing for a place near the top of the currency pyramid with no single dominant money (Cohen, 2019, p. 168).

Pathways for future research

The future of research in this area is closely tied with the evolution of the confrontation between the US dollar and the Chinese renminbi. As the renminbi reaches its maturity status as an international currency, it will likely elicit novel responses from other currency issuers, thereby providing novel evidence for advancements in the theory of reactive currency statecraft. Moreover, current empirical studies on this theory solely draw from the experiences of the Chinese yuan and responses from four countries, all advanced economies. Exploring the likely diversified reactions of a broader array of economies – advanced, emerging, and developing – promises to broaden our understanding and represents a concrete direction for future research.

In this context, the de-dollarization attempts by BRICS countries represent a starting focal point. Yet, potentially interesting scenarios could emerge from beyond these countries, both at individual and coalition levels. The rapidly shifting geopolitical landscape is reshaping international alliances and, as this review suggests, is likely to significantly influence global monetary relations. The interactions between Russia and China will be particularly crucial, especially as the 2024 US presidential elections approach, likely setting new directions for the US' geopolitical strategies and impacting broader international relations.

Finally, the rapid transformation and adoption of new financial technologies, notably block chain and digital currencies, represents a concrete venue for future inquiry. The rapid shift to digital infrastructures could enable a credible collective move away from the US dollar, especially as China continues to lead developments in this sector and to potentially position itself as a primary influencer in the setting of global standards. The extent to which this could concretely challenge the US dominance in global digital finance remains an open question for researchers.

Full Reference List

Arslanalp S., Eichengreen B., Simpson-Bell C. (2022), "The Stealth Erosion of Dollar Dominance and the Rise of Non-traditional Reserve Currencies", in *Journal of International Economics*, 138, September, 103656, https://doi.org/10.1016/j.jinteco.2022.103656.

Chey H-K. (2019), "The International Politics of Reactive Currency Statecraft: Japan's Reaction to the Rise of the Chinese Renminbi", in *New Political Economy*, 24(4), pp. 510-529, https://doi.org/10.1080/13563467.2018.1461820.

– (2022), *The International Political Economy of the Renminbi: Currency Internationalization and Reactive Currency Statecraft*, Routledge, Taylor & Francis Group, London-New York.

Cohen B.J. (2015), *Currency Power: Understanding Monetary Rivalry*, Princeton University Press.

– (2017a), *Renminbi Internationalization: A Conflict of Statecrafts*.

– (2017b), "The IPE of Money Revisited", in *Review of International Political Economy*, 24(4), p. 657-680, https://doi.org/10.1080/09692290.2016.1259119.

– (2019), *Currency Statecraft: Monetary Rivalry and Geopolitical Ambition*, The University of Chicago Press.

EICHENGREEN B.J. (2011), *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*, Oxford University Press, Oxford.

EICHENGREEN B., MEHL A., CHIŢU L. (2018), *How Global Currencies Work; Past, Present, and Future*, Princeton University Press, https://doi.org/10.2307/j.ctvc77684.

HELLEINER E. (2014), *The Status Quo Crisis: Global Financial Governance After the 2008 Meltdown*, 1st ed., Oxford University Press, New York.

– (2017), "Downsizing the Dollar in the Age of Trump? The Ambiguities of Key Currency Status", in *The Brown Journal of World Affairs*, 23(2), pp. 9-27.

HELLEINER E., KIRSHNER J. (2009), *The Future of the Dollar*, Cornell Studies in Money, Cornell University Press, Ithaca.

KIRSHNER J. (1995), *Currency and Coercion?: The Political Economy of International Monetary Power*, Princeton University Press, https://search.ebscohost.com/login.aspx?direct=true&AuthType=ip,sso&db=cat06685a&AN=ubba.b1117821&site=eds-live&scope=site&custid=s2944713.

LIU Z.Z., PAPA M. (2022), *Can BRICS De-Dollarize the Global Financial System?*, 1st ed., Cambridge University Press, https://doi.org/10.1017/9781009029544.

MCDOWELL D. (2019), "Currency Statecraft: Monetary Rivalry and Geopolitical Ambition", in *Political Science Quarterly*, Wiley-Blackwell, 134(4), pp. 725-726, https://doi.org/10.1002/polq.12977.

SUBACCHI P. (2017), *The People's Money: How China Is Building a Global Currency*, Columbia University Press, New York.