

## **De-Dollarisation: By George, I think they've (finally) got it!**

by Prof. Michael Hudson via nano - Global Research *Sunday, Jun 14 2009, 2:45am*

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### **The Yekaterinburg Turning Point**

Challenging America will be the prime focus of extended meetings in Yekaterinburg, Russia (formerly Sverdlovsk) today and tomorrow (June 15-16) for Chinese President Hu Jintao, Russian President Dmitry Medvedev and other top officials of the six-nation Shanghai Cooperation Organization (SCO). The alliance is comprised of Russia, China, Kazakhstan, Tajikistan, Kyrgyzstan and Uzbekistan, with observer status for Iran, India, Pakistan and Mongolia. It will be joined on Tuesday by Brazil for trade discussions among the BRIC nations (Brazil, Russia, India and China).



### ***Goodbye, George***

The attendees have assured American diplomats that dismantling the US financial and military empire is not their aim. They simply want to discuss mutual aid - but in a way that has no role for the United States, NATO or the US dollar as a vehicle for trade. US diplomats may well ask what this really means, if not a move to make US hegemony obsolete. That is what a multipolar world means, after all. For starters, in 2005 the SCO asked Washington to set a timeline to withdraw from its military bases in Central Asia. Two years later the SCO countries formally aligned themselves with the former CIS republics belonging to the Collective Security Treaty Organization (CSTO), established in 2002 as a counterweight to NATO.

Yet the meeting has elicited only a collective yawn from the US and even European press despite its agenda is to replace the global dollar standard with a new financial and military defense system. A Council on Foreign Relations spokesman has said he hardly can imagine that Russia and China can overcome their geopolitical rivalry,<sup>1</sup> suggesting that America can use the divide-and-conquer [strategy] that Britain used so deftly for many centuries in fragmenting foreign opposition to its own empire. But George W. Bush ("I'm a uniter, not a divider") built on the Clinton administration's legacy in driving Russia, China and their neighbors to find a common ground when it comes to finding an alternative to the dollar and hence to the US ability to run balance-of-payments deficits ad infinitum.

What may prove to be the last rites of American hegemony began already in April at the G-20 conference, and became even more explicit at the St. Petersburg International Economic Forum on June 5, when Mr. Medvedev called for China, Russia and India to "build an increasingly multipolar world order." What this means in plain English is: We have reached our limit in subsidizing the United States' military encirclement of Eurasia while also allowing the US to appropriate our exports, companies, stocks and real estate in exchange for paper money of questionable worth.

"The artificially maintained unipolar system," Mr. Medvedev spelled out, is based on "one big centre of consumption, financed by a growing deficit, and thus growing debts, one formerly strong reserve currency, and one dominant system of assessing assets and risks."<sup>2</sup> At the root of the global financial crisis, he concluded, is that the United States makes too little and spends too much. Especially upsetting is its military spending, such as the stepped-up US military aid to Georgia announced just last week, the NATO missile shield in Eastern Europe and the US buildup in the oil-rich Middle East and Central Asia.

The sticking point with all these countries is the US ability to print unlimited amounts of dollars. Overspending by US consumers on imports in excess of exports, US buy-outs of foreign companies and real estate, and the dollars that the Pentagon spends abroad all end up in foreign central banks. These agencies then face a hard choice: either to recycle these dollars back to the United States by purchasing US Treasury bills, or to let the "free market" force up their currency relative to the dollar - thereby pricing their exports out of world markets and hence creating domestic unemployment and business insolvency.

When China and other countries recycle their dollar inflows by buying US Treasury bills to "invest" in the United States, this buildup is not really voluntary. It does not reflect faith in the U.S. economy enriching foreign central banks for their savings, or any calculated investment preference, but simply a lack of alternatives. "Free markets" US-style hook countries into a system that forces them to accept dollars without limit. Now they want out.

This means creating a new alternative. Rather than making merely "cosmetic changes as some countries and perhaps the international financial organisations themselves might want," Mr. Medvedev ended his St. Petersburg speech, "what we need are financial institutions of a completely new type, where particular political issues and motives, and particular countries will not dominate."

When foreign military spending forced the US balance of payments into deficit and drove the United States off gold in 1971, central banks were left without the traditional asset used to settle payments imbalances. The alternative by default was to invest their subsequent payments inflows in US Treasury bonds, as if these still were "as good as gold." Central banks now hold \$4 trillion of these bonds in their international reserves - and these loans have financed most of the US Government's domestic budget deficits for over three decades now! Given the fact that about half of US Government discretionary spending is for military operations - including more than 750 foreign military bases and increasingly expensive operations in the oil-producing and transporting countries - the international financial system is organized in a way that finances the Pentagon, along with US buyouts of foreign assets expected to yield much more than the Treasury bonds that foreign central banks hold.

The main political issue confronting the world's central banks is therefore how to avoid adding yet more dollars to their reserves and thereby financing yet further US deficit spending - including military spending on their borders?

For starters, the six SCO countries and BRIC countries intend to trade in their own currencies so as to get the benefit of mutual credit that the United States until now has monopolized for itself. Toward this end, China has struck bilateral deals with Argentina and Brazil to denominate their trade in renminbi rather than the dollar, sterling or euros,<sup>3</sup> and two weeks ago China reached an agreement with Malaysia to denominate trade between the two countries in renminbi.<sup>[4]</sup> Former Prime Minister Tun Dr. Mahathir Mohamad explained to me in January that as a Muslim country, Malaysia wants to avoid doing anything that would facilitate US military action against Islamic countries, including Palestine. The nation has too many dollar assets as it is, his colleagues

explained. Central bank governor Zhou Xiaochuan of the People's Bank of China wrote an official statement on its website that the goal is now to create a reserve currency "that is disconnected from individual nations."<sup>5</sup> This is the aim of the discussions in Yekaterinburg.

In addition to avoiding financing the US buyout of their own industry and the US military encirclement of the globe, China, Russia and other countries no doubt would like to get the same kind of free ride that America has been getting. As matters stand, they see the United States as a lawless nation, financially as well as militarily. How else to characterize a nation that holds out a set of laws for others - on war, debt repayment and treatment of prisoners - but ignores them itself? The United States is now the world's largest debtor yet has avoided the pain of "structural adjustments" imposed on other debtor economies. US interest-rate and tax reductions in the face of exploding trade and budget deficits are seen as the height of hypocrisy in view of the austerity programs that Washington forces on other countries via the IMF and other Washington vehicles.

The United States tells debtor economies to sell off their public utilities and natural resources, raise their interest rates and increase taxes while gutting their social safety nets to squeeze out money to pay creditors. And at home, Congress blocked China's CNOOK from buying Unocal on grounds of national security, much as it blocked Dubai from buying US ports and other sovereign wealth funds from buying into key infrastructure. Foreigners are invited to emulate the Japanese purchase of white elephant trophies such as Rockefeller Center, on which investors quickly lost a billion dollars and ended up walking away.

In this respect the US has not really given China and other payments-surplus nations much alternative but to find a way to avoid further dollar buildups. To date, China's attempts to diversify its dollar holdings beyond Treasury bonds have not proved very successful. For starters, Hank Paulson of Goldman Sachs steered its central bank into higher-yielding Fannie Mae and Freddie Mac securities, explaining that these were de facto public obligations. They collapsed in 2008, but at least the US Government took these two mortgage-lending agencies over, formally adding their \$5.2 trillion in obligations onto the national debt. In fact, it was largely foreign official investment that prompted the bailout. Imposing a loss for foreign official agencies would have broken the Treasury-bill standard then and there, not only by utterly destroying US credibility but because there simply are too few Government bonds to absorb the dollars being flooded into the world economy by the soaring US balance-of-payments deficits.

Seeking more of an equity position to protect the value of their dollar holdings as the Federal Reserve's credit bubble drove interest rates down China's sovereign wealth funds sought to diversify in late 2007. China bought stakes in the well-connected Blackstone equity fund and Morgan Stanley on Wall Street, Barclays in Britain South Africa's Standard Bank (once affiliated with Chase Manhattan back in the apartheid 1960s) and in the soon-to-collapse Belgian financial conglomerate Fortis. But the US financial sector was collapsing under the weight of its debt pyramiding, and prices for shares plunged for banks and investment firms across the globe.

Foreigners see the IMF, World Bank and World Trade Organization as Washington surrogates in a financial system backed by American military bases and aircraft carriers encircling the globe. But this military domination is a vestige of an American empire no longer able to rule by economic strength. US military power is muscle-bound, based more on atomic weaponry and long-distance air strikes than on ground operations, which have become too politically unpopular to mount on any large scale.

On the economic front there is no foreseeable way in which the United States can work off the \$4 trillion it owes foreign governments, their central banks and the sovereign wealth funds set up to

dispose of the global dollar glut. America has become a deadbeat – and indeed, a militarily aggressive one as it seeks to hold onto the unique power it once earned by economic means. The problem is how to constrain its behavior. Yu Yongding, a former Chinese central bank advisor now with China’s Academy of Sciences, suggested that US Treasury Secretary Tim Geithner be advised that the United States should “save” first and foremost by cutting back its military budget. “U.S. tax revenue is not likely to increase in the short term because of low economic growth, inflexible expenditures and the cost of ‘fighting two wars.’”<sup>6</sup>

At present it is foreign savings, not those of Americans that are financing the US budget deficit by buying most Treasury bonds. The effect is taxation without representation for foreign voters as to how the US Government uses their forced savings. It therefore is necessary for financial diplomats to broaden the scope of their policy-making beyond the private-sector marketplace. Exchange rates are determined by many factors besides “consumers wielding credit cards,” the usual euphemism that the US media cite for America’s balance-of-payments deficit. Since the 13th century, war has been a dominating factor in the balance of payments of leading nations – and of their national debts. Government bond financing consists mainly of war debts, as normal peacetime budgets tend to be balanced. This links the war budget directly to the balance of payments and exchange rates.

Foreign nations see themselves stuck with unpayable IOUs – under conditions where, if they move to stop the US free lunch, the dollar will plunge and their dollar holdings will fall in value relative to their own domestic currencies and other currencies. If China’s currency rises by 10% against the dollar, its central bank will show the equivalent of a \$200 million loss on its \$2 trillion of dollar holdings as denominated in yuan. This explains why, when bond ratings agencies talk of the US Treasury securities losing their AAA rating, they don’t mean that the government cannot simply print the paper dollars to “make good” on these bonds. They mean that dollars will depreciate in international value. And that is just what is now occurring. When Mr. Geithner put on his serious face and told an audience at Peking University in early June that he believed in a “strong dollar” and China’s US investments therefore were safe and sound, he was greeted with derisive laughter.<sup>7</sup>

Anticipation of a rise in China’s exchange rate provides an incentive for speculators to seek to borrow in dollars to buy renminbi and benefit from the appreciation. For China, the problem is that this speculative inflow would become a self-fulfilling prophecy by forcing up its currency. So the problem of international reserves is inherently linked to that of capital controls. Why should China see its profitable companies sold for yet more freely-created US dollars, which the central bank must use to buy low-yielding US Treasury bills or lose yet further money on Wall Street?

To avoid this quandary it is necessary to reverse the philosophy of open capital markets that the world has held ever since Bretton Woods in 1944. On the occasion of Mr. Geithner’s visit to China, “Zhou Xiaochuan, minister of the Peoples Bank of China, the country’s central bank, said pointedly that this was the first time since the semiannual talks began in 2006 that China needed to learn from American mistakes as well as its successes” when it came to deregulating capital markets and dismantling controls.<sup>8</sup>

An era therefore is coming to an end. In the face of continued US overspending, de-dollarization threatens to force countries to return to the kind of dual exchange rates common between World Wars I and II: one exchange rate for commodity trade, another for capital movements and investments, at least from dollar-area economies.

Even without capital controls, the nations meeting at Yekaterinburg are taking steps to avoid being the unwilling recipients of yet more dollars. Seeing that US global hegemony cannot continue without spending power that they themselves supply, governments are attempting to hasten what

Chalmers Johnson has called “the sorrows of empire” in his book by that name - the bankruptcy of the US financial-military world order. If China, Russia and their non-aligned allies have their way, the United States will no longer live off the savings of others (in the form of its own recycled dollars) nor have the money for unlimited military expenditures and adventures.

US officials wanted to attend the Yekaterinburg meeting as observers. They were told No. It is a word that Americans will hear much more in the future.

#### NOTES:

1 Andrew Scheineson, “The Shanghai Cooperation Organization,” Council on Foreign Relations,

Updated: March 24, 2009: “While some experts say the organization has emerged as a powerful anti-U.S. bulwark in Central Asia, others believe frictions between its two largest members, Russia and China, effectively preclude a strong, unified SCO.”

2 Kremlin.ru, June 5, 2009, in Johnson’s Russia List, June 8, 2009, #8.

3 Jamil Anderlini and Javier Blas, “China reveals big rise in gold reserves,” Financial Times, April 24, 2009. See also “Chinese political advisors propose making yuan an int’l currency.” Beijing, March 7, 2009 (Xinhua). “The key to financial reform is to make the yuan an international currency, said [Peter Kwong Ching] Woo [chairman of the Hong Kong-based Wharf (Holdings) Limited] in a speech to the Second Session of the 11th National Committee of the Chinese People’s Political Consultative Conference (CPPCC), the country’s top political advisory body. That means using the Chinese currency to settle international trade payments ...”

4 Shai Oster, “Malaysia, China Consider Ending Trade in Dollars,” Wall Street Journal, June 4, 2009.

5 Jonathan Wheatley, “Brazil and China in plan to axe dollar,” Financial Times, May 19, 2009.

6 “Another Dollar Crisis inevitable unless U.S. starts Saving - China central bank adviser. Global Crisis ‘Inevitable’ Unless U.S. Starts Saving, Yu Says,” Bloomberg News, June 1, 2009.

<http://www.bloomberg.com/apps/news?pid=20601080&sid=aCV0pFcAFyZw&refer=asia>

7 Kathrin Hille, “Lesson in friendship draws blushes,” Financial Times, June 2, 2009.

8 Steven R. Weisman, “U.S. Tells China Subprime Woes Are No Reason to Keep Markets Closed,” The New York Times, June 18, 2008.

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