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De-Dollarization Efforts in China and Russia

For more than a decade, China and Russia have sought to reduce their use of the U.S. dollar, or “de-dollarize” their economies, in an effort to shield their economies from U.S. sanctions, reduce exposure to the effects of U.S. economic and monetary policy, and assert global economic leadership. While China and Russia have somewhat reduced their dollar use, both countries, as do most countries, still rely heavily on the dollar. China holds significant dollar reserves, and does not allow its currency, the renminbi (RMB), to be traded freely in foreign exchange markets. This limits the RMB’s use in cross-border transactions and has constrained China’s broader de-dollarization efforts. Russia’s ruble is not widely used abroad, and global energy markets (Russia’s main exports) are traditionally denominated in dollars. Over time, however, if de-dollarization efforts gain traction, there could be implications for the U.S. economy, U.S. sanctions, and U.S. global economic leadership.

The Global Role of the U.S. Dollar

The dollar has served as the world’s dominant reserve currency since World War II. A reserve currency is a currency held by central banks in significant quantities. It is also widely used in international trade and investment transactions. Today, the dollar remains the primary currency used in cross-border transactions, held by central banks in reserves, and traded in foreign exchange markets. The role of the dollar reflects global confidence in the U.S. Federal Reserve (Fed) as an institution and the U.S. economy and financial markets more generally.

The dollar’s global role also reflects continued U.S. global economic and financial leadership. The Fed has consistently demonstrated its capacity and willingness to bear the costs of backing up the global financial system, particularly during crises. Most recently, the Fed’s actions to provide dollar liquidity to the global economy stabilized international markets during the COVID-19 pandemic.

The dominance of the U.S. dollar in cross-border transactions allows the United States unique visibility and levers of influence through policy measures such as financial sanctions that impede access to the U.S. financial system or use of the U.S. dollar in international trade. Sanctions, imposed for foreign policy or national security objectives, restrict access to the U.S. payments and financial system, which is generally needed to process dollar transactions.

China’s De-Dollarization Efforts

China has tried for some time to de-dollarize in trade and investment with some limited success. The Chinese government has pressed trading partners, including Russia, to denominate some trade in RMB; established RMB trading centers in Hong Kong, Singapore, and Europe; and created cross-border stock exchange connection programs

that denominate some trade and investments in RMB. At the urging of the Chinese government, the International Monetary Fund added the RMB to its benchmark basket of key international currencies in 2016.

Despite these efforts, the dollar remains important to China and its global economic position. China holds 50%-60% of its foreign exchange reserves in dollar-denominated assets and conducted an estimated 20% of its trade in 2020 in RMB. The United States is a top export market for China. China also requires payment in dollars for most exports and *One Belt, One Road* projects. The PBOC controls the RMB’s value based on a basket of currencies weighted toward the dollar. Central banks globally hold 2% of their foreign reserves in RMB.

China is also seeking influence in dollar-centered global payments infrastructure. In January 2021, China’s central bank, the People’s Bank of China (PBOC), announced a joint venture (JV) with the Belgium-based financial messaging service, the Society for Worldwide Interbank Financial Telecommunications (SWIFT). SWIFT is relied on globally to send messages that facilitate cross-border financial transactions. The JV plans to create a data center and localized network in China that connects to the main SWIFT network and allows the Chinese government to monitor and control cross-border payments. Other shareholders are two PBOC-affiliated groups that handle cross-border RMB clearing and settlement services for banking and non-banking institutions.

De-Dollarization through Digital Currency?

China’s current de-dollarization efforts prioritize PBOC’s development of a digital currency. This initiative involves developing a domestic payment system that could be used globally, and advances China’s efforts to create alternatives to U.S.-controlled global economic, financial, trade, and technology networks. The effort aligns with China’s buildout of its national security economic authorities, including new export controls and sanctions laws.

The Chinese government is piloting domestic deployment with a focus on retail transactions as well as cross-border trade with Hong Kong, Thailand and the United Arab Emirates. Relatedly, China is piloting the joint use of foreign exchange and RMB in companies’ cash management and as cross-border financing for technology firms in designated zones. Ahead of the release of PBOC’s digital currency, the government has shuttered private bitcoin operations and tightened operating terms for financial technology service providers, such as Alibaba and Tencent. These firms are among a small group that PBOC has entrusted to distribute its digital currency.

China’s efforts to develop an alternative currency and financial network may not immediately challenge the global

role of the dollar due to the lack of full RMB convertibility, hesitancy of other central banks to use a digital currency, long-standing global acceptance of reliance on the U.S. dollar in particular sectors (oil and gas, for example), and national security concerns in other countries. Over time, however, a Chinese central bank digital currency and accompanying global payments network could offer China alternatives to the U.S. dollar and workarounds to U.S. sanctions, at least in certain instances. Collaboration with Russia or others could facilitate certain trade within closed networks. China's payments network could give China greater understanding and control of certain global financial flows.

China is already using its digital currency to propose global financial rules. At the Bank for International Settlements Innovation Summit in March 2021, China submitted a *Global Sovereign Digital Currency Governance* proposal that shares its views for standards on cross-border digital transactions, risk supervision, and data. At the event, the director of PBOC's Digital Currency Research Institute said that PBOC aims to become the first major central bank to issue a sovereign digital currency to propel RMB internationalization and reduce dependence on the dollar.

Russia's De-dollarization Efforts

The Russian government accelerated its de-dollarization in 2014, when the United States imposed sanctions on Russia in response to Russia's invasion of Ukraine. Over the next several years, the United States expanded sanctions on Russia for a variety of malign actions, including U.S. election interference. Russian President Vladimir Putin called for de-dollarization to insulate the Russian economy from existing and potential future U.S. sanctions.

Russia has focused de-dollarization efforts in three areas. First, the Russian government reduced its own holdings of dollars. Russia's central bank cut the share of its reserves denominated in dollars by more than half between 2013 and 2020. In July 2021, the Russian finance minister announced plans to completely remove from the country's sovereign wealth fund dollar-denominated assets, which accounted for about one-third of the \$186 billion fund.

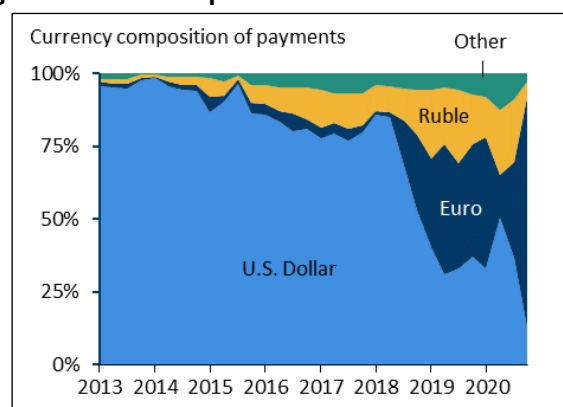
Second, Russia has reduced its share of trade conducted in dollars. The government has concluded various discussions and agreements with a number of countries—including China, India, Turkey, and other members of the Eurasian Economic Union (Armenia, Belarus, Kazakhstan, and Kyrgyzstan)—to prioritize the use of national currencies in bilateral trade. Russia's major state-owned energy companies also began transacting in euros and rubles where possible. These initiatives have shifted the currency-composition of Russia's trade. In Q4 2020, about 10% of Russia's exports to other BRICS countries (Brazil, India, China, and South Africa) were invoiced in U.S. dollars, down from about 95% in 2013 (**Figure 1**). About half of Russia's total exports, however, are still invoiced in dollars.

Third, Russia has developed its payment processing capabilities to reduce its reliance on the existing, dollar-centered payments infrastructure. Russia created a new national electronic payments system, *Mir* (which means "peace" and "world" in Russian), in 2015 after U.S.-based payment processing companies denied services to several Russian banks subject to U.S. sanctions. Russia also created

its own financial messaging system—the System for Transfer of Financial Messages (SPFS)—after the United States called for Russian banks to be disconnected from SWIFT. Russia has expanded the use of Mir and SPFS abroad: Mir has been introduced in Armenia, Turkey, and Uzbekistan, and 23 banks outside of Russia are connected to SPFS. Russia's central bank is also exploring the creation of a digital currency, which would further reduce Russia's reliance on western (and dollar-centered) payments infrastructure.

Despite these initiatives, President Putin acknowledged that Russia would not be able to completely de-dollarize, referring to the dollar as a "universal currency." Russia's central bank governor also affirmed that the bank would continue to hold dollar denominated-assets.

Figure 1. Russia's Exports to BRICS Countries



Source: Bank of Russia.

Outlook and Policy Issues for Congress

China and Russia's multi-year, multi-pronged efforts to de-dollarize have yielded minimal changes to date. However, if they are able to more significantly reduce their use of the dollar in the future, for example by expanding non-dollar trade or developing a digital currency, there could be implications for the United States. The United States benefits from the dollar's global status, by lowering the borrowing costs for the U.S. government and providing the United States with foreign policy leverage.

Policy questions Congress may want to consider include:

- What factors might make de-dollarization by Russia and China more successful in the future? What are the key signposts that the dollar's global role might be at risk?
- Are there legislative actions that could reinforce the dollar as the key international currency? How do various legislative efforts impact the dollar's role, if at all?
- Should Congress direct the Fed to create a digital currency, in order to maintain competitiveness and desirability of the U.S. dollar?
- Should Congress require the Treasury Department to produce an annual report on the use of the dollar international economy? If so, should this report discuss the use of sanctions and the role of the dollar?

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