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Master thesis:

**DOLLARIZATION PROCESSES IN THE WORLD ECONOMY**

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## INTRODUCTION

**Actuality of the research.** In a broad sense, dollarization refers to the replacement of the domestic currency by foreign currency in the economic life of a country or region, which performs the main function of currency, that is, as a store of value, a unit of account or a means of payment. In most cases, the foreign currency used is the US dollar. In fact, dollarization means that the dollar plays an important role in the world. As a process, dollarization means that the dollar will play an increasingly important role in the depth and breadth of monetary and financial activities outside the United States. Dollarization, as a policy, is the process by which the government of a country or an economy gradually lets the dollar replace its own currency and eventually automatically relinquishes monetary or financial sovereignty. We can refer to the above three meanings of dollarization simply as de facto dollarization, process dollarization, and policy dollarization.

The theoretical research on currency internationalization mainly focuses on the realization conditions and mechanisms of international money supply. But in the international economy, money is determined by the decisions and actions of public and private agents of all States in the market. With the change of currency competition pattern and the expansion of transaction network, the relationship between currency demanders and economic and trade partners becomes increasingly complex. The dollar gradually becomes the de facto world currency, accounting for a very large proportion in international trade settlement, foreign exchange transactions, net international bonds, international bank deposits, debts of developing countries and official foreign exchange reserves. Opinions are divided on whether dollarization is a blessing or a curse. But we have to admit the importance of the dollar in the international economy. Since the collapse of the Bretton Woods system, the US dollar has remained strong in the global economy and become the world currency. Before the euro, there was a de facto "dollarised economy". The number of countries that have dollarized is huge. The basic structure of

dollarized countries shows that small countries are active and determined implementers of dollarization. Some developing countries choose dollar-based currency system, which has an important impact on their economy, and thus on the world economy.

Different aspects of dollarization are presented in numerous scientific papers. The theoretical basis for the current state of dollarization in the world economy is given in the writings of Yan Yi, Hao Zhiqiang, Wang Yonghui, Li Huanli, Li Shikai, Liu Mingli, Grader Geng Dan, Tang Renwu, Ceng Kanglin, Yu Qun 'e and many others.

**The goal** of the research is to carry out a comprehensive analysis of the current state of dollarization in the world economy and to find effective ways for transformation of monetary policy in conditions of dollarization. In order to implement the goal, the following tasks were set and solved:

- to research the emergence of the international currency;
- to review the US dollar as the "bellwether" of the international currency;
- to research the international currencies in the period of financial crisis;
- to analyse the positive impact of the dollarization on the world economy;
- to analyse the current state of dollarization in the world economy;
- to review the negative impact of dollarization of the world economy;
- to find out strategic vectors of de-dollarization of the world economy;
- to consider the transformation of monetary policy in conditions of dollarization.

The **object** of the study is dollarization in the world economy.

The **subject** of research is the search for the tools to transformation of monetary policy in conditions of dollarization.

The **methods** of research. The methodological basis of the thesis is theoretical concepts of the dollarization. The following general scientific and special methods of research were used: historical-logical, scientific generalization, induction and deduction, analysis and structural synthesis, structural-dynamic analysis, analogy, classification, identification, generalization. The information base of the study consists from official

publications and analytical materials of the UN, IMF, World Bank; domestic and foreign fundamental works, professional editions.

The **scientific novelty** of the results obtained is the new formulation and solution of the scientific and practical problem of transformation of monetary policy in conditions of dollarization and defining strategic vectors of de-dollarization of the world economy.

The **practical significance** of the results obtained is that systematized theoretical and practical provisions, generalized world experience can be used in the formation, development and implementation of transformation of monetary policy in conditions of dollarization. Scientific developments of the author can be used in the organization of cooperation of industrial, scientific, financial, social structures of different countries with international partners.

**Structure of the research.** The thesis of a total volume of 58 pages consists of an introduction, three sections, conclusions, contains a list of references from 60 titles. The thesis is illustrated with 1 drawing and contains 1 table.

## **CHAPTER 1**

### **THE CAUSE OF THE DOLLARIZATION OF THE WORLD ECONOMY**

#### **1.1. The emergence of the international currency**

The earliest world currencies were "gold and silver". Each country has its own currency, but each country's currency has a different value and cannot be circulated in other countries or regions, so it is difficult to gain recognition from other countries. In ancient times, in international trade, people mainly used barter, or gold, silver to trade.

With the advent of the Age of navigation, the British colonized many parts of the world with their ships and guns. The British colonies all over the world, through plunder, trade, as well as gold mining, robbed the world's gold to Britain. When the English had a large amount of gold, they linked their currency, the pound sterling, to gold. A thousand pounds was worth ten tael of gold. Gold is good, but it is inconvenient and unsafe to carry, which brings a lot of trouble to traders engaged in international trade and commodity trade. The pound was portable, and Britain was an empire on which the sun never set, with colonies and businesses all over the world. When the pound was convertible into gold, merchants around the world easily accepted the pound, and it eventually replaced gold and silver as the "world currency." [7]

How did the dollar replace the pound as the new "world currency"? In the 14th and 15th centuries, Europeans began to explore the sea in order to preach, plunder gold and open up overseas markets, and discovered the Americas and other new continents. Subsequently, the Dutch, Spanish and Portuguese, through colonial expansion, colonial plunder and the sale of black slaves, to earn huge wealth, which makes the British envy, in order to compete for the supremacy of the sea and Spain, in August 1588, the British Navy and Spain's "Armada", in the English Channel carried out a world attention, fierce and spectacular sea battle. Unexpectedly, Spain's Armada was defeated by the Royal Navy, and Britain replaced Spain as the new hegemon of the seas. And then a lot of the

world was colonized by the British. When Britain was at its strongest, it covered an area of 3,300 square kilometers, covering all continents. Therefore, Britain was also known as the "Empire on which the sun never sets" and was truly the world's leading power. By the 20th century, the whole world had been divided up by Britain and France. After the rise of Germany, there was not much land left for Germany to occupy. To redraw the world's spheres of influence. In 1914, Germany started the First World War, but the outcome was not satisfactory to the Germans, and the Central Powers with Germany as the core were defeated by the Allies of Britain, France, Russia and other countries. The British, having won World War I, were barely holding on to their world dominance, but the United States and the Soviet Union were also rapidly rising. In 1939, the Germans, not willing to lose the first World War, started the second World War. Many countries on the European continent were defeated by Germany under the fierce blitzkrieg offensive. Even France, which had "the first Army in Europe", only resisted for 42 days before surrendering to Germany.

After the fall of the European continent, Britain was still holding out and refusing to surrender. After the outbreak of World War II, the United States pursued an "isolationist" policy and refused to participate in the wars in Europe and Asia. However, the United States took the opportunity to sell supplies to other countries and made war money. At first, the British used sterling to buy goods from the United States. But soon, the Americans were afraid that England would print money to win the war and make their sterling worthless. So they asked the British to use gold to buy goods from them. The British needed supplies to fight the Germans, so they had to accept American demands. At the same time, other countries also needed gold to buy goods from the United States. As a result, the world's gold reserves flowed into the United States. After the Japanese attack on Pearl Harbor in 1941, the United States was involved in World War II, but the United Kingdom, the Soviet Union and other countries were unable to resist the war without supplies from the United States. With the aid of the US, countries defeated the invaders and won World War II, but the US became the biggest winner of World War II

by selling supplies and making a lot of money. After World War II, Britain was devastated. At the same time, under the intervention of the United States and the Soviet Union, Britain's colonies all over the world became independent, which weakened Britain and inevitably declined. The United States replaced Britain as the new world's leading power. The Americans wanted to create a new world order with themselves at the center. First, the American president proposed the formation of the United Nations with the United States and the Soviet Union at its core, instead of the League of Nations with Britain and France at its core. Second, the United States wanted its currency, the dollar, to replace Britain's pound sterling as the new "world currency." During World War II, the British used their gold to buy goods from the United States, so they didn't have enough gold to maintain the sterling gold exchange system. During the Second World War, the United States allowed countries to use gold to buy supplies for itself, which gave the United States 73.4 percent of the world's gold reserves after the war. At this time, the United States was ambitious and wanted to replace Britain and make its currency, the dollar, the "world currency" [32].

From July 1 to 22, 1944, 730 representatives from 44 countries, including the United States, the Soviet Union, China and France, held a joint national monetary and financial conference at the Washington Hotel in Bretton Woods, New Hampshire, USA, and adopted the Final Resolution of the United Nations Monetary and Financial Conference, the Agreement of the International Monetary Fund and the Agreement of the International Bank for Reconstruction and Development, which were collectively called the Bretton Woods System, and established the dollar-centered system. The Bretton Woods system is a gold exchange standard system based on the US dollar and gold. Its basic contents include that the US dollar is linked to gold, and the currencies of IMF member countries maintain a fixed exchange rate with the US dollar (a fixed exchange rate system is implemented). The United States issues dollars and converts them into gold at the official exchange rate. Countries have accepted the US dollar as the "world currency" and allowed them to exchange US dollars for gold without restriction. The



dollar has also become the means of payment for international settlement and the main reserve currency of various countries [18].

Balance of payments accounting is aimed at foreign economic transactions, aiming to reflect the economic relationship between residents (permanent units) of an economy and other parts of the world (foreign countries, that is, non-permanent units). The accounting results provide a basis for formulating foreign economic policies, analyzing the basic economic factors affecting the balance of international payments, and taking corresponding macro-control measures. The balance of payments accounting is connected with the flow accounting and stock accounting of foreign parts in other accounting, which reflects the process and results of foreign transactions and is an important part of the national economic accounting system. A complete balance of payments accounting consists of balance of payments statement and international investment position statement. Among them, the balance of payments reflects all economic transactions between residents (permanent units) and non-residents (non-permanent units) of an economy in a certain period, including three parts, namely current account, capital and financial account (including international reserves), net error and omission; The international investment position table reflects the stock of foreign financial assets and liabilities of residents in an economy at a specific time, as well as the stock changes caused by changes in transactions, prices, exchange rates and other adjustments in a certain period of time. The items in the international investment position table are consistent with those in the financial account in the balance of payments, including direct investment, securities investment, financial derivatives and employee stock options, other investments, and international reserves.

Dynamically speaking, the balance of payments activity describes a kind of economic phenomenon, reflecting a country in a certain period of all foreign currency receipt and payment activities. At a static level, the balance of payments describes the results of a country's monetary payments compared with those of other countries. This result is systematically recorded to form the balance of payments.

International settlement currency refers to the currency in which the import and export contracts are denominated during the trade between residents and non-residents. Residents can make payments to non-residents in this currency, and non-residents are allowed to hold deposit accounts in this currency for international settlement. If the parties only specify the currency of valuation but not the currency of settlement in the contract, the currency of valuation is the currency of settlement. The trading parties may also specify one currency as the denomination currency and another currency as the settlement currency. The currency of international settlement is generally the currency of higher international recognition [12].

Foreign scholars have also studied the reasons for the choice of international settlement currency. Swoboda thinks that the currency with low transaction costs will be the medium of exchange. The reason for the low transaction costs is that the currency has high trading volume and high liquidity in the foreign-exchange market. Moreover, the less volatile the currency's exchange rate, the lower its transaction costs. Krugman analyzed the reasons for choosing international trade settlement currencies from the perspective of transaction costs, and concluded that the currencies of countries with dominant balance of payments would be the international settlement currencies under the assumption that transaction costs decrease with transaction scale. Dowd, Greenway and Hartmann hold that the "network externality" theory of currency transaction holds that the larger the transaction scale of currency, the lower the transaction cost. Economies of scale tend to align the use of currencies for international trade settlements. Only when the new currency has obvious non-network advantage over the existing currency, the currency substitution will occur on a large scale. Hartmann's research also shows that the size of an economy is directly proportional to how internationalized its currency is. Donnenfeld and Zilcha stage analysis and optimization strategy put forward a classical model of settlement currency selection (DZ model), which helps explain the choice of settlement currency for foreign trade in developing countries. They believe that export commodity demand elasticity and exchange rate stability are two factors in the choice of settlement currency. When export

demand elasticity is low and domestic exchange rate is unstable, foreign currency settlement is an advantageous strategy compared with local currency settlement, and vice versa. The DZ model does not take into account that prices are sticky in the short term. Obsfeld and Rogoff integrate the traditional sticky price theory and imperfect competition theory into the dynamic general equilibrium theory analysis, affecting the subsequent research on the choice of international settlement currency. Tavlas believes that choosing the currency of exporting country as the settlement currency of international trade is positively correlated with the degree of differentiation of exported products. Donnenfeld and Haug's research, along with Floden and Wilander's, shows that the size of both economies plays a significant role in the choice of settlement currency. Devereux and Engle argued that the choice of settlement currency is related to the stability of monetary policy. In addition, the level of sophistication of financial markets also affects the choice of settlement currency, and Helence believes that if there is a lot of trade in the currency in the foreign exchange market, this will promote the use of the currency on a wider scale. Once the currency is settled, the increase in market volume and the decrease in transaction costs will consolidate the currency's status as a settlement currency. The study of Hartmann, Fukuda and Ono also shows that the use of settlement currency has strong historical inertia and convergence, and those economies with greater strength are more inclined to choose their own currency as the international settlement currency.

## **1.2. The US dollar as the "bellwether" of the international currency**

At present, there are US dollars, euros, pounds, Hong Kong dollars, RMB, Canadian dollars, Singapore dollars, Japanese yen, Australian dollars, New Zealand dollars, Mexican pesos, Philippine pesos, Indonesian rupiah, Thai baht, Malaysian ringgit, Swiss francs, United Arab Emirates dirham, Swedish krona, Polish zloty, Israeli new shekel, Saudi riyal, Turkish lira, South African rand and so on. According to the degree

of internationalization and the important position in the world finance and trade, these currencies can be divided into three levels: central currency, sub-central currency and peripheral currency [30].

The US dollar is the only central currency and also the key currency. It occupies a dominant position in the international monetary system with absolute advantages. Until now, only the dollar has been able to fully perform the major functions of trade investment, financing, reserves and payment settlement. The currencies of each country can be exchanged for the U.S. dollar, which can be exchanged for gold at any time. Whether it is the settlement of international payments between banks or the government's intervention in the market for the purpose of exchange rate stabilization, the US dollar has undoubtedly been the most important currency in the official foreign exchange reserve. Once the rules of the exchange market are established and most national banks use the dollar as the medium of currency exchange, the transaction costs of this market will decrease with the increase of liquidity, and then all but the majority of banks will be attracted to use the dollar voluntarily.

In the late 1960s and early 1970s, unemployment, inflation and the dollar crisis became three serious problems in the American economy. On August 15th, 1971, the Nixon administration announced the implementation of the "New Economic Policy", aiming at maintaining the economic dominance of the US dollar externally, controlling inflation internally and stimulating economic recovery. The implementation of the "new economic policy" marks the demise of the hegemony of the US dollar in post-war international finance. Later, the IMF determined the US dollar, euro, pound and yen as a basket of SDR currencies, which were regarded as international currencies by the market. Later, RMB was also identified as the SDR basket of currencies, which increased the number of international currencies to five currencies. Although the dollar has lost its dominance, it is still the most important international currency so far.

After the outbreak of COVID-19 epidemic, the United States launched unprecedented financial and monetary rescue measures, which pushed up the huge budget

deficit and led to the sharp depreciation of the US dollar. Countries with a large amount of dollar assets are worried that the US government would allow inflation and erode the value of dollar securities in order to reduce debt, which has once again triggered the discussion on the dominant position of the dollar. Because of the epidemic, the international status of the US dollar has been affected in four aspects, namely, value scale, value storage, medium of exchange and means of payment.

First of all, the continued depreciation of the dollar reduces its usefulness as a measure of value. Since the outbreak of the epidemic in the United States in March, 2020, the US dollar index has dropped from a high of 99. The spread and recurrence of the epidemic have intensified the market's concerns about the economic prospects of the United States and further strengthened the decline of the US dollar. With the large-scale anti-epidemic measures and economic stimulus policies introduced one after another, the decline of the US dollar index has slowed down, but it still shows a trend of low volatility. The dollar index is a tool for measuring the value of the dollar. When it fluctuates greatly, the value scale error caused by the US dollar is obvious, and the actual value of the US dollar debt and assets will shrink. Second, the declining share of the US dollar in global reserves weakens its role as a store of value. According to the data of the International Monetary Fund, the share of US dollars in global reserves was 58% in 2024, down 14% from 72% in 2002.

After Biden came to power, large-scale anti-epidemic measures and economic stimulus policies were introduced, and the decline of the US dollar index slowed down, but it still showed low level of shock. The dollar index is a tool for measuring the value of the dollar. When it fluctuates greatly, the value scale error caused by the dollar is obvious, and the true value of dollar debts and assets will shrink. Secondly, the share of the US dollar in global reserves has dropped to the lowest point in 25 years, weakening its role as a means of value storage. According to the data of the International Monetary Fund (IMF), in the fourth quarter of 2020, the global share of dollar-denominated reserves fell to 59%, the lowest in 25 years [42]. In contrast, when the European Union introduced

the euro in 1999, the proportion was 71%; In 2017, when Trump began the trade war, the ratio was 64.7. The share of the US dollar in global reserves has been declining, and the epidemic has accelerated this trend, because central banks have increased their holdings of other currencies in international transactions, changed the composition of currency reserves, and used assets instead of the US dollar as a means of value storage. Third, some oil-producing countries in the world are considering switching to non-US dollar oil-denominated currency to reduce the role of the US dollar as a medium of exchange. In response to U.S. sanctions, Russia, Iran and some European countries have been actively reducing their dollar-denominated trade. On the one hand, some oil-producing countries are considering pricing oil with a basket of currencies in order to avoid the shrinking of dollar asset. On the other hand, shrinking demand for oil has created a buyer's market, which gives buyers more bargaining power and right to speak, and is conducive to settlement in local currencies instead of US dollars. Petroleum trade accounts for nearly 10% of the global trade. The settlement of oil trade in US dollars has established the monetary function of US dollars as a direct exchange medium in international trade. Signs that the oil trade is gradually decoupled from the US dollar have actually weakened the monopoly position of the US dollar as a trading medium. Fourth, the rise of currency derivatives, and the decline of the dollar as a means of payment. Over the past decade, digital currencies and payment instruments, such as central bank digital currencies, global stable coins and cryptocurrencies, have provided the portfolio with faster payment means, more dollars and speculative methods. During the epidemic, more and more citizens used digital currency for transactions and settlement, replacing traditional cash transactions. Many governments realized the role of digital payments in reducing the risk of the virus transmission. The Central Bank of Kenya exempts financial transactions completed through mobile banking, and Myanmar government issues one-time payments to vulnerable citizens through local digital platforms such as Wave Money and One pay. Both decentralized virtual currencies and sovereign central bank digital currencies, with its convenient cross-border payment, have affected the dollar-dominated payment system

to varying degrees. Although the absolute dominance of the dollar has been affected, it has not been significantly weakened.

Sub-central currencies are mainly official currencies of western developed countries, such as euro, pound, yen, Swiss franc and so on. They are not in the same category as the dollar but they are highly internationalized, with most sub-central currency countries having virtually no capital controls and free capital flows.

Political factors make it difficult for the euro to exert its power. The euro is now the second most commonly used reserve currency, accounting for about a quarter of global reserves. The size of the euro zone's economy is equal to that of the United States. The role of the euro in the world is not only measured by trade; More than 20% of bond issuance in the international market is denominated in euros. The euro did have a real incentive to fight the dollar. The collapse of the U.S. dotcom bubble in 2000 and the September 11 attacks caused a gradual outflow of a large amount of money that had brought prosperity to the U.S. in the 1990s. Europe could overtake the United States as the largest economy if it could absorb capital from outside the United States. If the euro becomes an international currency alongside the dollar, it will enjoy the currency privilege of buying goods and services with euro paper.

European enterprises can operate in the euro zone without being affected by the exchange rate between the euro against the US dollar. The biggest obstacle to the development of the euro is that it is not a real country, but an economic community organized through treaties. A major conflict among its members in monetary policy could lead to deadlock or collapse, so the European Central Bank is facing greater risk than the Federal Reserve. Second, the European Central Bank has not issued all-European bonds for many years, and each country's bonds have their own independent yields, which increases the complexity and risk of the reserve currency and weakens the reserve value of the euro. During the epidemic, the European Union agreed to a rescue plan for novel coronavirus, which was the first time to pool debts between member countries through new collective bonds or to provide a more stable and liquid long-term investment portfolio.

Even so, it will take a long time to develop into an investment asset as mature and liquid as US Treasury bonds. Third, the European debt crisis highlights the defects of the euro system. By failing to narrow the economic gap between the developed countries and the "problem countries" in the EU, the EU can not stimulate domestic demand to boost economic growth. These "problem countries" are under pressure from public spending cuts, high debt burdens and social unrest, often using the euro as a scapegoat for their ill-judged economic policies and a target for popular attack [3].

The role of the Japanese yen as a reserve currency is stable but relatively unimportant. After the collapse of the Bretton Woods system, the international monetary system was once in disorder and confusion, which created opportunities for the rise of the yen. Japan used to be the strongest growth engine in the world, with low inflation rate and a current account surplus. The yen was regarded as a potential challenger to the dollar. Apart from American repression, there are deeper reasons for the yen's decline than the isolationist tendencies of Japan's export-driven post-war reconstruction system, in which most Japanese government bonds are held at home, limiting the supply of yen-denominated reserves. The yen has long benefited from its status as a safe haven in Asia, second only to the U.S. and China in terms of economic size, but Japan's economy faces long-term challenges from a rapidly aging population, heavy reliance on the U.S. market and a persistent economic downturn. Nowadays, the yen is also used as a reserves currency, but Japan's public debt accounts for too much of GDP, second only to Zimbabwe and Greece. Investors will not like the yen better because of their financial stability.

Peripheral currencies have realized free convertibility to a large extent, but the local government restricts the holding of local currency assets by non-residents and the internationalization of local currency, such as countries such as Singapore and South Korea.

In recent years, China's rapid economic growth and China's status as a big trading country have promoted the rise of RMB on the global stage, and the use of RMB has been increasing remarkably. But the important symbol of currency internationalization is the



degree of liquidity, free circulation and free exchange is the concrete form. From this perspective, there is still a big gap between RMB and other sub-central currencies such as Euro and yen. Due to objective conditions, China still implements capital controls. For example, people are limited to exchanging the equivalent of \$50,000 per person per year; For another example, the flow of RMB into or out of China needs to be approved by the Foreign Exchange Bureau. Investment in US stocks can only be made through QDII funds, and individuals have no direct investment channels. In addition to accepting their own currency, people in many countries privately use the US dollar for transactions. With the US dollar, they can buy the goods and services they need everywhere, which even the Euro cannot do, let alone the RMB. There is a huge gap between the degree of internationalization of the RMB and the US dollar.

### **1.3. International currencies in the period of financial crisis**

The relationship between exchange rate regime arrangement and economic growth is a controversial issue. The internationalization of the US dollar may be an accident of history. Even though it achieved its dominant position in the world by occupying the "right time, geographical location and people", we cannot deny its "excellence" as "The Times make heroes". In the late 1990s, three events with profound influence occurred in the international financial field: the Southeast Asian financial crisis, the advent of the euro and the wave of dollarization from Latin America. Former US Secretary of State Henry Kissinger once said, "Whoever controls oil controls the country, who controls food, who controls human beings, who controls currency, who controls the whole world." Although celebrities may not be right, reality does not lie. America's core interests have always been in this direction, which is oil, food and the dollar. But compared with some other countries, this is child's play. Some countries, such as Panama, El Salvador, Zimbabwe, Timor-Leste, Palau and Ecuador, do not issue their own currencies but use US dollars directly. Some of

these countries are affiliated countries of the United States; Some countries are particularly small, and it makes sense to use the US dollar for convenience and economic reasons, but Ecuador is an exception.

Ecuador is larger than the United Kingdom at 250,000 square kilometers, but has a population of only 17.46 million, mostly of mixed race. Historically, South America was colonized by Spain and Portugal. The colonists first came from the sea by ships. Ecuador was colonized by Spain in 1532, freed from Spanish rule in 1822, and founded in 1830. After independence, Ecuador did not take the road of rapid development. First, it joined the Republic of Gran Colombia and then became independent. It fell into the cycle of civilian and military alternates in power. Ecuador has had 15 presidents in 40 years from 1980 to 2020, with an average term of 2.6 years. Many of them were removed from office by unusual means. Although Ecuador is rich in animal and plant resources, its industrial structure is relatively simple. In 1950s and 1960s, Ecuador planted bananas and became the largest banana kingdom in the world. Ecuador, a former Opec member with 8.3 billion barrels of oil reserves, enjoyed a period of oil prosperity after the 1970s. With a crude economic base and a volatile political situation, the country's ability to resist risks is very small, and even the slightest disturbance may be catastrophic. Unfortunately, Ecuador is plagued by earthquakes and meteorological disasters. It has also contributed to Ecuador's economic collapse.

The legal tender of Ecuador was the sucre from 1884 to 2000. On January 9, 2000, then-President Hamil Mavad announced that Ecuador would adopt the U.S. dollar as its currency and that the Sucre would be converted to dollars within eight months. Ecuadoreans who learned the news were a little sad, but not a lot surprised. In fact, before the president's announcement, Ecuadoreans had quietly converted more than half of their assets into dollars. It is unusual for ordinary people in a sovereign country to exchange their assets into foreign currency. The then president Mawad announced the withdrawal of the sucre from 2000 and the adoption of the U.S. dollar as the official currency to "dollarize" the economy. The president's order is merely a formality. Mawad, with his

unaccomplished efforts, cannot change the tide of history, the Sucre collapse and the rise of the dollar are inevitable. This can also be seen in the fact that 12 days after the abolition of Sucre, the Mawad regime was overthrown, but the dollarization policy was inherited by a new government. So 2000, although Ecuador's first year of dollarization was declared, was not the beginning of its dollarization [53].

As we all know, personnel rights and financial rights are the core resources of any unit. Whoever controls these two things is the real boss. For a country, issuing money is one of the integral parts of sovereignty. Ecuador will not give up the right to issue money unless it has to, so what has happened to Ecuador? The answer is mostly inflation.

On inflation, Keynes famously said that "through continuous inflation, the government can secretly and unknowingly confiscate the wealth of its citizens, leaving the majority poor and the few rich". Ecuador's annual inflation has risen by almost 30% since 1982. By the end of the 20th century, inflation in Ecuador was not just harvesting wealth but killing it. If you saved enough money to buy a big house in 1982, you would only have enough money to buy a toilet five years later, but in 2000, there may not even be room to stand. The reasons can be summarized as follows: 1. Excessive money issuance, the government superstitious Keynesian, in order to stimulate effective demand to issue more money. 2. Structural shortage of commodities and backward production base Government welfare increases and deficit expands. 3. Prices are rising due to international inflation.

In addition to South America's problems, the international community is not at peace. When the Asian financial crisis broke out in 1998, financial giants such as Soros ran from left to right in Asia, and Thailand, the Philippines, Malaysia, South Korea, Chinese mainland, Hongkong and Taiwan Province were all affected. Among them, the Indonesian rupee depreciated by 47%, the Malaysian rand depreciated by 35%, the Russian ruble depreciated by 70%, and the peak value of the Korean won depreciated by more than 100%, leading to the closure of industrial and commercial enterprises. A large number of international capital fled. This wave of Asian financial crisis in the world set

off a wave, everywhere in the path of grief, the only benefit is the US Wall Street financial bosses.

Due to the financial crisis, the international oil demand has been declining. However, on the supply side, OPEC's crude oil output has increased instead of decreasing, mainly because Venezuela's continuous increase in crude oil production in violation of the production reduction agreement has caused dissatisfaction among other member States. In December 1997, Saudi Arabia joined other OPEC countries to increase production to seize market share. In the case of increasing oversupply, the price of crude oil has fallen sharply. This is a disaster for Ecuador, which relies heavily on oil exports. Its GDP fell by 30% that year, from \$27.9 billion to \$196 billion. International rating agencies took advantage of the turmoil by downgrading Ecuador's credit rating. Foreign investment was withdrawn on a massive scale, depriving the economy of dollars [37].

The fundamental reason why Ecuador lost its sovereign currency is the liberalization policy of the financial system, which is the root cause of its long departure. Since the 1980s, Ecuador has gradually liberalized its financial policy. In 1994, the government promulgated the Law on General Financial Institutions, which further relaxed the control of financial institutions in the country. During this period, deposit interest rates in Ecuador were as high as 40%, while the deposit interest rates in the United States were only 5%. The difference between the two was eight times. That is, if an institution could borrow money from the U.S. market and deposit it in an Ecuadorian bank, it could make a fortune doing nothing all year long. Therefore, the stability of exchange rate is the premise of arbitrage. The Ecuadorian government has guaranteed the exchange rate between the U.S. dollar and the Sucre by executive order. With the opening up of Ecuador's financial freedom, the two currencies are tightly tied together, and the last fear of speculators has been eliminated. The Bank of Ecuador began to borrow dollars on a large scale to invest in oil and agriculture. Of course, the loan interest rates is sky-high, and banks interest rates alone can bankrupt companies, and it will not exceed the profit rate. The bottom line of this high-interest domino is the windfall of Ecuador's oil exports.

As luck would have it, 1998 was an eventful year, with an earthquake in Ecuador knocking out oil exports for six months, a financial crisis reducing world demand and Opec making oil cheap. As the combination of blows went on, the Ecuadorian economy could not withstand it at first, the enterprises went bankrupt and the currency depreciated, then there was a run on the bank, and people wanted to change dollars everywhere, and the bank began to close down. In December 1998, in order to rescue banks and credit, the government began to provide guarantees for customers' deposits, but the government did not have much US dollars. The guarantee turned out to be a blank check. Banks are going bust more and more.

At the beginning of 1999, the government announced that it would freeze private deposits and issue US dollar bonds to finance banks, but the effect was not obvious. As the government has less and less dollars, it was difficult to maintain the fixed exchange rate. Sucre began to depreciate on a large scale after it was announced that it would float against the US dollar. In 1999, the value of the Sucre depreciated by 67% in one year. The free fall of the Sucre depreciated at a speed like that. Ecuadorean people fully realized what time is money. The Sucre deposits, which the government had administratively frozen and which were due to mature in March 2000, were a bomb hanging over Ecuador's head. Surprisingly, however, there has been no rush to convert deposits into dollars, thanks to the timely emergence of the World Bank and the IMF. The commitment of international organizations and the dollar brought confidence to the common people, and financial stability brought social stability. After the dollarization of Ecuador, the problem of excessive economic fluctuations was really solved, the inflation rate dropped and the gross domestic product grew steadily.

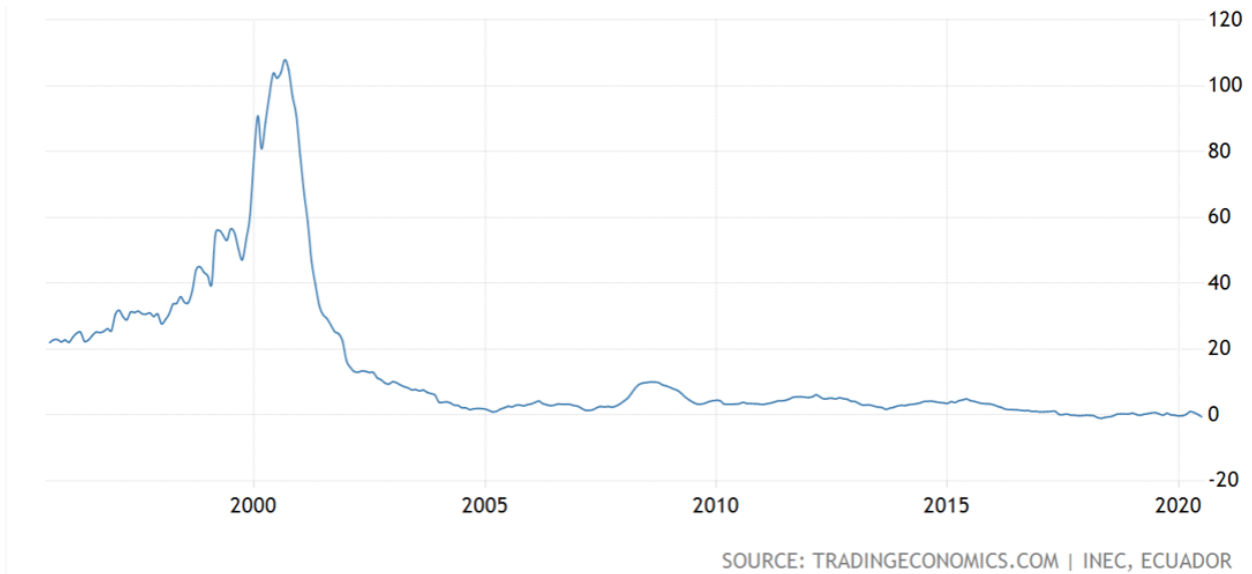


Fig. 1.1. Changes of the exchange rate [32]

Some experts argue that dollarization, which Ecuador has been using for 23 years, has helped defuse interest rate risk, curb inflation and maintain economic stability. Ecuador gave up its monetary sovereignty and its economy took off. By analyzing the changes of the exchange rate regime in Latin America, we can draw the following conclusions: First, we must choose the exchange rate regime according to the actual situation of the country. Second, compared with East Asia, Latin America's exchange rates often fluctuate wildly. Dollarization is regarded as a special institutional arrangement to avoid exchange rate risks.

Ecuador is an example of de facto dollarization. The experience of Ecuador shows that dollarization actually reduces inflation, but at the cost of increasing the fluctuation of the business cycle. The most important conclusion about Ecuador's experience is that changes in the monetary regime do not solve structural economic problems, such as a lack of productivity growth or, in Ecuador's case, an over-dependence on oil. After the economic polarization, if the old economic structure still exists, it can still have a debt crisis, just like what happened in Ecuador recently.

## **Conclusions to Chapter 1**

Money, as a medium of transaction and a measure of value, has experienced ups and downs in its evolution. In this series of evolution, more and more countries began to adopt the US dollar as the currency in circulation. The appearance of this phenomenon is the result of many factors.

Among many international currencies, the dollar stands out and becomes the leader of the world economy. First of all, the rise of the American economy has laid a solid foundation for the international status of the US dollar. Since the end of 19th century, American economy has developed rapidly and become one of the most powerful countries in the world. Especially after the Second World War, the United States became the world's hegemon with its strong economic and military strength. A large amount of funds flowed into the United States, which promoted the internationalization of the US dollar. Secondly, the establishment of the Bretton Woods system further consolidated the international status of the US dollar, making it the core of the international monetary system and providing institutional guarantee for the internationalization of the US dollar. In addition, the dollar has become the preferred currency for investors and consumers around the world with its strong ability to maintain value and liquidity. While the international status of the US dollar is constantly consolidating, more and more countries begin to adopt the US dollar as the currency of circulation, which is called dollarization.

In the context of the global financial crisis, the international status of the US dollar has once again become prominent. During the financial crisis, the economies of various countries were severely impacted and the financial markets were in turmoil. In order to cope with the crisis, countries have adopted policies and measures such as currency depreciation and interest rate reduction in an attempt to stimulate economic growth. However, these policies and measures often lead to the instability of currency value and aggravate the fluctuation of financial markets. In this context, with its strong strength and stability, the US dollar has become a safe-haven currency for global investors. When the

financial market is in turmoil, investors often choose to convert their funds into dollars to avoid risks. This trend has further promoted the internationalization of the US dollar, making its position in the global economy more stable.



## **CHAPTER 2**

### **THE IMPACT OF DOLLARIZATION ON THE WORLD ECONOMY**

#### **2.1. The positive impact of the dollarization on the world economy**

Under the background of financial globalization, dollarization has penetrated into every aspect of economic life of transition countries, and dollarization has both advantages and disadvantages for transition countries.

From a global perspective, we must strengthen financial cooperation. Dollarization is a rational choice of economic subject based on the motivation of risk avoidance, and it is an inevitable and spontaneous phenomenon in the process of marketization. The dominant position of the US dollar in the international monetary system and the emergence of the dollarization phenomenon prove that it does have certain positive effects, such as avoiding financial crisis, reducing trade flows, reducing currency risks and so on.

The positive effect of dollarization is that the transaction costs will be greatly reduced. Transaction costs here mainly refers to the costs caused by different currencies, including the handling fee for currency exchange, the income of trading opportunities hindered by the existence of exchange rate risks and the costs caused by measures taken to avoid exchange rate risks. Dollarization will reduce the cost and risk of foreign exchange transactions, facilitate the development of foreign trade and attract foreign investment, so as to promote the integration of national economies with the world economy, enhance competitiveness and promote the improvement of domestic economic efficiency [45].

In theory, dollarisation is nothing more than the instinctive or forced response of most economies to "trilemma" choices. For any economic entity, it usually seeks three monetary and financial goals: first, to have an independent monetary policy in order to use the interest rate lever to fight inflation or economic recession; Second, to maintain a relatively stable exchange rate in order to eliminate or reduce the uncertainty caused by

currency fluctuations and the disturbance of the financial system; Third, ensure full convertibility of the currency so that capital can come and go freely. However, these three goals are logically and operationally contradictory. As a basic principle of international financial theory, an economy can achieve at most two of these goals simultaneously (i.e. sacrifice at least one of them). This "trilemma" in international finance leaves each economy with only one of three exchange rate regimes. The first is the hard pegged exchange rate system, including two systems: no separate legal tender (that is, dollarization) and currency board arrangement. The second is the floating exchange rate system, including managed floating and free floating. The third is the soft pegged exchange rate system, also known as the intermediate exchange rate system, including traditional pegged, stable arrangement, crawling pegged, quasi-crawling pegged and horizontal range pegged. The basic meaning of dollarization is that by giving up one of the three policy objectives of monetary policy independence, the two objectives of currency stability and capital free flow can be achieved almost "once and for all", so that the decision makers can avoid having to take into account the above three policy objectives at the same time, but the result can only be the dilemma of focusing on one and losing the other [23].

This raises a question: if an emerging economy can only give up one of its goals if it wants to avoid the dilemma, is monetary independence the most worthwhile goal to give up? In fact, the cost of preserving the goal of monetary independence is relatively high. In order to maintain the independence of monetary policy, floating exchange rate system or soft peg exchange rate system can be implemented. Theoretically, floating exchange rate system allows a country to maintain a certain degree of monetary policy independence, but the market often overreacts to economic performance, either pushing the value of an economy far below its real value or far above it. In the first case, inflation, debt and interest burden will rise or increase; In the second case, the competitiveness and trade balance of products will decline and deteriorate. More importantly, once a country's weak economy falls into a dilemma, it cannot guarantee to achieve the other two goals at the same time.

In other words, the goal of implementing a fixed exchange rate policy to maintain monetary independence can only be abandoned. Economists agree that if an economy wants to benefit from a fixed exchange rate system, it must either strictly control capital flows to limit speculation or promise that the market can effectively curb speculation. If a country is not going to adopt a policy of capital controls that would do great damage to the free flow of capital, the preferable alternative is to have a currency board system that closely resembles a currency standard such as the dollar. For some small economies, at least, dollarisation seems to be the way to go: the greater of both benefits and the lesser of two evils.

In many emerging market economies, politicians often print a lot of money for their short-term political interests, which leads to vicious inflation and ultimately undermines economic growth. One of the main positive results of dollarisation has been to force the establishment to accept tougher budgetary constraints and follow economic rules. Dollarization can enhance the discipline of currency issuance. It is prudent for people to choose which currency the central bank issues, which creates favorable policy conditions for the long-term stable development of the economy. Dollarization is conducive to the stability and deepening of the domestic financial market, to the integration of the domestic market and the international market, to the prevention of capital outflow, and to greatly reduces the possibility of a currency crisis.

It can be seen from several financial crises in Latin American countries that people's distrust of their own currencies and policies and the sudden intensification of this distrust are the trigger of the crisis, and the lack of sufficient capacity of these national governments and international financial institutions in the process of preventing and dealing with financial crises makes people's distrust intensified. Since there is no local currency in circulation after full dollarization, sharp depreciation of the local currency and sudden capital outflow due to the fear of currency devaluation are avoided. At the same time, full dollarization has high credibility. Once full dollarization is implemented, the cost of abolishing it will be quite large. Especially when bilateral dollarization is adopted,

it will be more difficult to terminate the status of the dollar as legal tender. As a result, dollarization can give full play to its "commitment effect" in avoiding currency crisis and international balance of payments crisis, which is conducive to improving the "credibility" of the government, reducing national risks and avoiding the impact of external shocks, so as to stabilize the macro economy. The gains from dollarization are most beneficial for countries with a history of currency crises or that are more vulnerable to external shocks.

The traditional criteria for optimal currency areas assume that the main benefits of forming a common currency area are increased trade and investment gains due to reduced exchange rate risk, but fail to take into account that in many Latin American countries, due to a long history of inflation and poor macroeconomic policies, governments generally lack the "credibility" to fight inflation, making monetary policies committed to price stability ineffective for a long time. Therefore, the credibility of "import" becomes another motivation for a country to dollarize. The credibility of "importing" from Deutsche Bank was an important factor in many EU member states joining the European Monetary System and eventually becoming members of the European Union. In Latin America, however, no sub-region has a large country with a history of monetary stability from which it can "import" credibility, a big difference from Europe. So a European Union-like monetary union in Latin America is unlikely. For Latin American countries, the only real "import" of anti-inflation credibility on the continent is the United States; A currency union with the United States or unilateral dollarisation is thus the (unlikely) last resort for Latin America.

From the point of view of political economy, dollarization means a drastic institutional change. In view of the inevitable impact of dollarization on the pattern of vested interests, that is to say, different groups will bear different profits and losses and benefits in this process, so whether the dollarization policy is implemented or not and how fast it is implemented depends on the results of the game or bargaining between different interest groups.

## **2.2. The negative impact of dollarization of the world economy**

The financial crisis has exposed many defects and risks of dollarization, such as charging seigniorage, transferring inflationary pressure, and the United States often imposes financial sanctions without justifiable reasons.

Independent monetary policy has two related but different meanings. One is policy independence in a broad sense, that is, the ability of an economy to implement monetary policy according to the actual economic operation, including the fluctuation of interest rates, the adjustment of money supply and the fluctuation of exchange rate. The second is the narrow sense of policy independence, which means that monetary policy can be implemented without interference from other factors, such as not having to raise interest rates to defend a fixed exchange rate.

Due to currency substitution, when the public chooses to hold foreign currency, the increase of foreign currency in circulation will seriously interfere with the implementation of monetary policy and weaken the effect that policy should achieve. For countries that implement full dollarization, their monetary policies will completely lose their independence, that is, their monetary policies depend on those of the United States, but the monetary policies of the United States may not be applicable to their actual conditions.

The dollarized economy no longer has the tools of exchange rate policy to respond aggressively and specifically to "asymmetric shocks" that affect different members of the dollar zone in different directions. ; Not receiving the benefits of exchange rate depreciation because of the inability to adjust the real exchange rate; The reintroduction of local currency as legal currency would be a lengthy and complicated process.

The impact of currency substitution and dollarization on a country's macro economy is firstly reflected in the effect of monetary policy. The impact of currency substitution on monetary policy mainly focuses on the following aspects:

1. Independence of monetary policy. The "triple paradox" of international economics dictates that formal dollarization will inevitably lead to a loss of monetary

policy independence when strict capital controls are difficult to implement. The loss of the right to issue money would prevent the central bank from acting as lender of last resort when the banking system runs into liquidity difficulties. What's more, when the economy of dollarized countries falls into recession, it is difficult to use fiscal policy to stimulate the economy due to the limited domestic financing capacity of the government and the fragility of international foreign debt. Moreover, the loss of independence makes the domestic monetary policy only subordinate to the American monetary policy which is not suitable for the national situation, thus greatly weakening the macroeconomic regulation function of the government.

According to Mundell-Fleming model, a country can only maintain the independence and effectiveness of its monetary policy by adopting a floating exchange rate system. However, in the context of the gradual relaxation of financial regulation, because a country's currency is not necessarily a non-substitute from the perspective of demand, currency substitution will occur even under the floating exchange rate system. If the majority of residents and enterprises in a country hold a diversified investment portfolio, then the independence of monetary policy is no longer true. In addition, the financial opening under financial globalization has increased the difficulty and cost of macro-policy operation, and it is difficult to achieve the expected regulatory effect by implementing independent monetary policy. As for the lender of last resort, we should not overemphasize the negative effects of dollarization. In fact, the ability of central banks to respond to the crises simply by printing money is limited. On the contrary, since polarized countries will definitely allow foreign financial institutions to enter freely, foreign banks should not only improve the competitiveness of domestic financial institutions and stabilize the financial situation, but also play the role of lender of last resort. A stable dollar will also reduce the risk of bank run. It is possible.

2. Money supply and demand. The substitution of foreign currencies to local currencies to varying degrees will not only weaken the controllability of money supply, but also increase the instability of domestic monetary demand, thus affecting the effect of

a country's monetary policy. First of all, when the monetary authority of a country increases the supply of base money, the cost of holding the local currency will decrease due to the decrease of interest rate, so the demand for the local currency will rise accordingly. If the foreign country does not implement the same monetary policy in the same period, part of the demand for the local currency will flow abroad, so the increase of domestic price is lower than that without currency replacement. The continuous supply of currency will strengthen people's expectation of local currency depreciation and increase the opportunity cost of holding local currency. Therefore, domestic residents will increase their holdings of foreign currency and reduce their demand for local currency. In this case, there will be a deviation between the actual money supply and the nominal money supply, which makes it difficult for the expansionary monetary policy to achieve the desired goal. Secondly, when the monetary authority adopts the tightening monetary policy, although inflation declines, the degree of currency substitution will not decrease due to the time-lag of currency substitution and the established cost of the conversion of local and foreign currencies. Therefore, the demand for local currencies will not increase rapidly, thus affecting the tightening effect of monetary policy. In addition, even if the domestic money supply does not change, due to the existence of currency substitution, when the monetary policy of the surrogate country contracts or expands, the supply and demand of the domestic currency will be affected, thus affecting the realization of the domestic monetary policy objectives.

For emerging economies, currency substitution is asymmetric, that is, foreign residents have no demand for local currency when there is the possibility of converting local currency into foreign currency. Therefore, the impact of currency substitution on domestic currency supply and demand is mainly reflected in that residents' demand for currency shifts from local currency to foreign currency when local currency has strong depreciation expectation or the return rate of foreign assets is significantly higher than that of domestic currency. Thus, it is difficult to increase employment and expand production through expansionary monetary policy.

3. Intermediate goal of monetary policy. Currency substitution makes the supply and demand of money affected by exogenous factors, so as an intermediate target of monetary policy, the role of money supply will be weakened. In addition, adjusting the interest rate will cause the holding cost of a country's currency to be higher than the actual rate of return, which will lead to currency substitution, so it is difficult for the monetary authorities to use the change of interest rate to regulate the economy. Seigniorage revenue, as defined by Webster's New University Dictionary, "is the difference between the circulating value of money and the value of the precious metal ingot in which it is minted and the cost of minting it." Seigniorage now usually refers to the income a central bank receives from issuing money. Under paper money, when there is no inflation, seigniorage comes from the increased demand for money that accompanies economic growth. When there is inflation, seigniorage is also known as an inflation tax (obtaining seigniorage by printing money is only effective in the short term and will be offset in the long run by people's inflation expectations). Under the monetary board system, seigniorage is derived from the difference between the income of securities purchased by the Monetary Board with reserve currency (usually interest paid on purchases of U.S. government debt) and the cost of keeping the currency in circulation. According to common estimates, this type of seigniorage, which can be called narrow seigniorage, is usually only 0.2% of a country's GDP (Krugman 1998). In a broad sense, the seigniorage of losses in dollarised economies should also include the foreign exchange reserves they own that have been used to dollarise. These reserve assets come from either current account or capital account surpluses and constitute claims on the United States or other dollar-receiving economies by non-dollarized economies [52].

Seigniorage is the difference between the cost of currency issuance and its value in the circulation market when the currency issued by the central bank enters the circulation market. If the country is dollarized and the dollars issued by the Federal Reserve enter the domestic market, then the seigniorage originally obtained by the country will be transferred to the Federal Reserve government. The US Federal Reserve prints a large



amount of dollars, and the dollars circulate around the world and enter the market to buy real goods or services. Then the US can use very low cost to buy goods produced by other countries at a large cost, and directly obtain the national wealth of other countries.

For example, it costs nearly 5 cents to mint a dollar coin in the United States, and the government earns 95 cents for every dollar coin it issues. A dollar bill costs only one or two cents, so the profit is 99-98 cents. A \$100 bill costs about the same as a \$1 bill, so the profit is \$99.99 - \$99.98. The modern seigniorage income situation is different from the original seigniorage income. In fact, the currencies issued by modern countries are all uncashed paper money, which is a kind of credit money based on the credit of the state or the government. The government cannot issue more money without limit, because if the issue of money exceeds the amount of money needed for circulation, it will cause inflation, and the purchasing power of money will decline, so the government can get limited seigniorage income through the above forms. However, as long as non-interest-paying notes circulate as money, the government continues to earn interest, which it must repay if it borrows money. The government steadily earns this interest in an environment free of inflation. Therefore, the modern seigniorage income is mainly obtained through the form of interest. Simply put, when the economy needs to increase the money supply, the Federal Reserve buys securities from the public, who deposits the checks they receive with banks, which in turn deposit the checks with the Federal Reserve system to meet the required reserve rate. In this case, the Federal Reserve receives interest income from the securities and returns most of the interest to the Treasury, known as seigniorage income. The currency in circulation issued by the Federal Reserve System is its liability. The assets opposing this liability are in the form of bonds issued by the United States Treasury and corporate bonds recognized by the United States government. The Federal Reserve System issues non-interest-bearing debt securities (money) and uses the proceeds to buy financial assets that earn interest. The Federal Reserve turns over to the United States Treasury the vast majority of the income from these interest-bearing assets that exceeds the Federal Reserve's expenditures and capital expenditures.

Dollarization in East Asia reduces the income of currency cooperation in East Asia. The strong dollar policy puts East Asian countries in a dilemma when facing dollar hegemony, which affects the realization of the ultimate goal of currency cooperation in East Asia to a certain extent [2].

It should be noted that although economists intend to determine precisely the advantages and disadvantages of dollarizing economies and thus the scope of dollarization, this is only from an economic point of view. In fact, political factors are very important in promoting or discouraging dollarization. Swiss scholar Harris Dellas and IMF's George Tavlas(2001) argued through research that although the political benefits of creating a new currency (Euro) in the EU outweigh the political costs, the implementation of dollarization in the Americas and other regions seems to be much higher than the political costs of floating exchange rate system and currency board system. The euro zone establishes monetary union through the creation of a new currency. The political benefits mainly include: (1) Euro can compete with the US dollar in the market, and as a reserve asset, it improves Europe's bargaining position and power in inter-governmental monetary negotiations (Cohen,1996); (2) Germany's trading partners who have sold seigniorage in EMS hope to regain their influence on monetary affairs (De Grauwe,1993); (3) Created important symbols for the eventual political merger (Cohen,1996). The cost of creating the euro was simply the loss of a symbol that distinguishes countries: their currency. But dollarisation, mainly unilateral, involves individual countries unilaterally abandoning their own currencies in favour of the dollar as their legal currency, which is clearly vulnerable to nationalist opposition. In Brazil, for example, which sees itself as South America's economic leader, dollarisation may be economically beneficial but politically impossible; Although Canada has a high degree of economic integration with the United States, as a large country, it also faces strong political pressures, says Simon Frazer Univ, a Canadian academic. James Dean(2001) believes that the reasons for dollarization in Canada are much weaker than those in Latin American countries. In Mexico, despite majority dissatisfaction with The peso, when asked "Do you agree to give up the peso and

let Mexico lose its currency", 71% disapprove and only 27% approve (note: The Los Angeles Times, Oct.10.1998); A 1999 survey in Argentina also showed that 74% of Argentines disagreed with dollarisation; Even in small Central American countries where dollarization makes sense for the economy, it still has popular opposition. In Ecuador, for example, where ordinary people believe that the sucre, the currency, has Ecuadorean "history, culture and dignity," only 59 percent of those polled supported the government's plan to dollarize. Therefore, whether an economy wants to dollarize should not only analyze economic factors, but also political factors.

### **2.3. Analysis of the current state of dollarization in the world economy**

As the most important reserve currency and internationally traded currency in the world, the US dollar plays an important role in the global economic system. Although the Bretton Woods system collapsed in the 1970s, the international status of the US dollar did not waver. On the contrary, with the promotion of globalization and financial liberalization, the status of the US dollar was further consolidated. At present, the US dollar accounts for more than 60% of the global foreign exchange reserves, and its proportion in international transactions is much higher than that of other currencies.

Countries or regions that use the US dollar as their main currency are: the United States (including Puerto Rico, Northern Mariana Islands, Virgin Islands, American Samoa, Guam, American Pacific Islands and other American overseas territories), El Salvador, Panama (circulating US dollars and issuing US dollar equivalent tokens in Panama), Ecuador, East Timor (circulating US dollars and issuing US dollar equivalent tokens), Marshall Islands, Micronesia (Federated States of) and Palau. In addition, central banks and financial institutions in many countries regard the US dollar as a safe-haven asset to stabilize domestic financial markets and cope with external shocks. As the core currency of the world economy, the influence of the US dollar has already surpassed the national

boundaries of the United States and penetrated into every corner of the world. From America to Asia, from Europe to Africa, and then to Oceania, the influence of the dollar is everywhere.

*Table 2.1*

**World-Official Foreign Exchange Reserves by Currency(US Dollars,Billions)**

	Q2 2023	Q3 2023	Q4 2023	Q1 2024	Q2 2024
Total Foreign Exchange Reserves	12,050.50	11,845.68	12,347.16	12,383.61	12,347.42
Allocated Reserves	11,176.21	10,977.44	11,453.21	11,498.25	11,465.52
Claims in U.S. dollars	6,640.39	6,496.75	6,690.71	6,774.82	6,675.45
Claims in euro	2,204.44	2,146.83	2,284.33	2,253.79	2,265.29
Claims in Chinese renminbi	273.38	260.61	262.17	247.1	245.17
Claims in Japanese yen	600.18	601.3	651.68	654.52	641.07
Claims in pounds sterling	532.63	527.92	557.13	562.48	565.92
Claims in Australian dollars	219.7	222.54	245.53	248.42	256.45
Claims in Canadian dollars	279.6	275.4	296.47	295.64	306.85
Claims in Swiss francs	21.17	19.79	22.27	21.93	22.43
Claims in other currencies	404.72	426.3	442.92	439.56	486.89
Unallocated Reserves	874.29	868.24	893.95	885.35	881.9

SOURCE:<https://data.imf.org/?sk=e6a5f467-c14b-4aa8-9f6d-5a09ec4e62a4>

Especially in America, dollarization is particularly obvious, which not only affects the economic development of various countries, but also profoundly changes people's lifestyles. In North America, the status of the dollar is almost unshakable. Canada and the United States, as the two major economies in the North American Free Trade Area, have close economic ties, and the circulation of US dollars in Canada is also extremely extensive. Although Canada has its own official currency, the Canadian dollar, on many occasions, the US dollar is also accepted as legal tender. This phenomenon of "de facto dollarization" not only facilitates the trade between the United States and Canada, but also

promotes economic prosperity. Mexico, as a neighbor of the United States, is deeply influenced by the United States. The circulation of the US dollar in Mexico is also extremely common, especially in the border areas, where the US dollar has almost become the "second currency".

In South America, dollarization is also significant. Brazil and Argentina, as the two largest economies in South America, have their own official currencies, but the use of US dollars in international trade, finance and investment is increasing. Especially in the face of economic problems such as currency depreciation and inflation, many enterprises and individuals prefer to use US dollars for transactions and savings to avoid risks.

The phenomenon of dollarization in Central America and the Caribbean is more prominent. There are many small countries in this region, with relatively backward economy and fragile financial system. Therefore, many countries have chosen dollarization as a means to stabilize the economy and promote development. For example, Panama has used the US dollar as the official currency since 1904, and it is the first country in the world to use the US dollar as the legal tender except the United States. Ecuador, on the other hand, announced in 2000 that it would abandon its national currency, Sucre, and fully adopt the US dollar as the official currency. Although this move has stabilized Ecuador's economy to a certain extent, it has also lost the independence of monetary policy and faced the risk that its economy is highly dependent on American economic policy [47].

The attitude towards dollarization in Asia is relatively complicated. For historical, economic and cultural reasons, some countries and regions, such as Singapore, China and Hongkong, have adopted the exchange rate system linked to the US dollar or used it as the main trading currency. These countries and regions usually have a relatively open economic system and a high degree of internationalization, so dollarization is helpful to reduce transaction costs and improve the efficiency of financial markets. However, while enjoying the convenience brought by the dollar, Asian countries are also under the pressure brought by the hegemony of the dollar. Whenever the US economy fluctuates,

especially when the Federal Reserve adjusts its monetary policy, Asian countries often bear the brunt. A stronger dollar will lead to the relative depreciation of other currencies, which in turn will curb the export growth of Asian countries and aggravate the downward pressure on the economy. In addition, dollar hegemony also enables the United States to influence the global economic trend through monetary policy and financial markets, which is sometimes abused to achieve political or military purposes and seriously infringes on the economic sovereignty of other countries.

For most Asian countries, it is more important to maintain the independence and stability of their currencies. These countries usually adopt a more cautious monetary policy and exchange rate system to avoid the risks caused by excessive dependence on the US dollar. At the same time, with the rise of Asian economy and the strengthening of regional cooperation, some countries have begun to explore alternatives such as establishing a regional monetary system or promoting the internationalization of the RMB to reduce their dependence on the US dollar. The rise of the trend of dollarization is not only a silent protest against the hegemony of the dollar, but also the inevitable result of Asian countries seeking economic independence and autonomy. In the practice of dollarization, Asian countries have adopted various strategies. On the one hand, by strengthening bilateral or multilateral trade agreements, promoting regional monetary cooperation and establishing a common payment system, we can reduce our dependence on the US dollar. On the other hand, the stability and competitiveness of China's financial market can be enhanced by increasing the holdings of gold reserves or other currencies, adjusting China's monetary policy, improving financial laws and regulations, improving market transparency and strengthening supervision. The rise of RMB is a bright spot in the process of dollarization. With the rapid growth of China's economy and the promotion of its international trade status, the status of RMB in the international market has gradually increased. More and more countries began to include RMB in their foreign exchange reserves and establish closer economic ties with China. In addition to RMB, other currencies in Asia are also emerging in the process of dollarization. The Indonesian rupiah,

Indian Rupee and Singapore dollar are playing an increasingly important role in international trade and regional cooperation. These countries have great potential for economic development and are increasing trade cooperation with other countries, using local currency to settle accounts and reducing their dependence on the US dollar. De-dollarization is not only an economic issue but also a political and security issue. In the process of dollarization, Asian countries need to face the complicated international political and economic environment and balance the relationship between economic independence and international cooperation. At the same time, it is necessary to strengthen regional cooperation and trust to jointly deal with the challenges and risks brought about by the hegemony of the dollar. Only in this way can Asian countries move forward more confidently on the global economic stage.

As an important pole of the world economy, the trend of dollarization of Europe's economy is equally significant. Europe has undergone profound changes in the monetary field. The birth of the euro marks the successful practice of European monetary integration, and also poses a challenge to the international status of the US dollar. As a common European currency, Euro has played an important role in promoting intra-European trade, reducing transaction costs and improving the efficiency of financial markets. Although the euro, as the unified currency of Europe, has a strong influence within Europe, it is still inferior to the US dollar in international competition. At the same time, the internationalization of the euro is also advancing, becoming the second largest reserve currency and one of the international trading currencies in the world. However, the rise of the euro has not completely replaced the position of the dollar in the global economy, and the dollar still occupies a dominant position in the fields of international trade, finance and investment. Among the foreign exchange reserves of many European countries, the proportion of US dollars is still high; In international trade, the US dollar is often used as the currency for pricing and settlement. In addition, the position of the US dollar in the global financial market is even more unshakable, and many European investors regard US dollar assets as an important investment choice. In addition, the economic performance

and policy coordination of the euro zone are also facing many challenges, such as debt crisis and weak economic growth, which may affect the international status of the euro and the trend of dollarization [56].

The dollarization of the world economy has many influences on Europe. First of all, dollarization has promoted trade and investment between Europe and the world. As the US dollar is widely used in the global economy, adopting the US dollar as the transaction currency can greatly reduce the transaction cost and improve the transaction efficiency. This will help European enterprises to expand the international market and enhance their international competitiveness. However, dollarization has also brought certain challenges to Europe. On the one hand, the fluctuation of the US dollar exchange rate will have a direct impact on the European economy. When the dollar appreciates, the competitiveness of European export products will decrease, and the import cost will increase, thus putting pressure on the European economy. On the other hand, dollarization has also aggravated the volatility of European financial markets. Due to the dominant position of the US dollar in the global financial market, the change of the US dollar exchange rate will often lead to the turmoil in the global financial market, and the European financial market will not be spared. In addition, dollarization has brought some complexity to the formulation of European monetary policy. When the European Central Bank formulates its monetary policy, it needs to fully consider many factors such as the exchange rate of the US dollar, the global economic situation and the uniqueness of the European economy, which makes the formulation of monetary policy more complicated and difficult.

The attitude towards dollarization in Africa is relatively conservative. Due to historical, economic and political reasons, the monetary system of African countries is relatively fragile and vulnerable to external shocks. Therefore, many African countries choose to maintain the independence and stability of their currencies in order to avoid the risks caused by excessive dependence on the US dollar. With the economic growth in Africa and the strengthening of regional cooperation, some countries have begun to explore the establishment of a regional monetary system or strengthen monetary



cooperation with other countries. Nevertheless, the US dollar still plays an important role in economic activities in Africa, especially in international trade and finance. The present situation of dollarization in Africa presents diversity and complexity. Some countries, such as Liberia and Zimbabwe, have officially adopted the US dollar as legal tender due to historical reasons or economic difficulties. These countries usually face serious problems such as inflation and currency depreciation, and the adoption of US dollars will help stabilize the economic environment and enhance investor confidence. At the same time, although many African countries have not formally adopted the US dollar, it still occupies an important position in international trade, financial transactions and daily life and has become the de facto "second currency". Under the background of globalization, African countries need to find a development model that can not only use external resources but also maintain economic autonomy.

Oceania has a small number of countries and relatively small economies, and its influence in the global economic system is limited. With the in-depth development of global economic integration, Oceania countries have also begun to actively participate in international trade and financial activities, and the status of the US dollar as an international transaction currency has also been reflected in this region.

As the largest country in Oceania, Australia's economic scale and influence should not be underestimated. Australia did not adopt dollarization policy, but insisted on using its own Australian dollar as the official currency. Although there are exchange rate fluctuations between the Australian dollar and the US dollar, the Australian government has successfully maintained the stability and credibility of the Australian dollar through flexible monetary policy and sound financial management. In addition, as a resource-rich country, Australia's export income mainly comes from resource commodities such as minerals and agricultural products. The international pricing of these commodities is often linked to the US dollar, but the independent status of the Australian dollar gives Australia more bargaining power and flexibility in international trade.

The relationship between New Zealand's currency choice and dollarization is more complicated. The New Zealand dollar (NZD), as the official currency of New Zealand, was once linked to the British pound in history, but with the evolution of the global monetary system, NZD gradually realized independent floating. Although New Zealand is not fully dollarized, its monetary policy is closely linked to the US dollar. When the Bank of New Zealand formulates monetary policy, it often considers the change of the exchange rate of the US dollar and the policy trend of the Federal Reserve, which makes the New Zealand dollar maintain a certain correlation with the US dollar. However, the New Zealand government did not give up the independent management of the New Zealand dollar, but maintained economic stability and growth through flexible exchange rate policies and monetary policies [8].

Other island countries in Oceania, such as Papua New Guinea and Solomon Islands, often choose the US dollar or other strong currencies as the trading medium because of their small economic scale and imperfect financial system, which is "de facto dollarization".

### **Conclusions to Chapter 2**

Dollarization has had a far-reaching impact on the world economy, and the phenomenon of dollarization has left a deep mark all over the world, whether in America, Asia, Europe, Africa or Oceania.

The positive impact of dollarization is first reflected in reducing the cost of currency exchange, simplifying the international trade process and improving the convenience of foreign trade. As a globally recognized stable currency, the inflation level of the US dollar is usually low. Therefore, countries that adopt dollarization can enjoy lower inflation rate, thus maintaining stable economic growth. In the period of financial turmoil, dollarization can enhance market confidence, reduce the risk of capital flight and provide solid support for the country's economic development.

However, dollarization is not without its drawbacks. Its biggest negative impact lies in the erosion of the independence of national monetary policy. The loss of independence

of monetary policy not only limits the government's ability to regulate and control the economy, but also may lead to the loss of competitiveness of its own currency, thus affecting the country's economic development. Dollarization will also affect the relationship between the country's money supply and demand. In dollarized economies, the US dollar has become the main transaction currency, and the demand for domestic currency will drop sharply. This may lead to excess domestic money supply, which in turn may lead to inflation or asset bubbles. As the US dollar is the main reserve currency in the world, its supply has an important impact on the global economy. Dollarized countries will passively accept changes in the supply of dollars, which undoubtedly increases the uncertainty of their economies. Although dollarization can reduce the level of inflation, long-term dependence on the US dollar may lead to the domestic price level in line with international standards, and then affect the competitiveness of domestic industries. Dollarized countries will lose the ability to adjust interest rates independently and will not be able to cope with changes in domestic economic conditions through interest rate policies. Dollarization will make the national exchange rate linked to the US dollar, and it is impossible to flexibly adjust the exchange rate according to the changes in the international economic environment, thus increasing the exchange rate risk.

Although dollarization is not without cost, dollarization still has strong vitality. Ecuador and Panama in America are typical representatives of complete dollarization, and their economies have maintained steady growth under the impetus of dollarization, and the trend of dollarization in America may be further strengthened in the future. Some countries in Asia, Europe, Africa and Oceania have adopted dollarization policies to varying degrees, but the effects are different.

The influence of dollarization on the world economy is a double-edged sword. Some countries have stabilized their economies through dollarization, while others have fallen into economic difficulties. For many small countries, dollarization is an effective means to stabilize the economy, attract foreign investment and promote development. For big countries, dollarization is an important way to strengthen economic ties and promote

regional integration. The widespread existence of dollarization not only reflects the core position of the dollar in the global economy, but also reveals the reality of interdependence and mutual influence among countries' economies under the background of globalization. When deciding whether to adopt dollarization policy, countries should fully consider its advantages and disadvantages, weigh the changes of domestic and international economic environment and make wise choices.

## **CHAPTER 3**

### **PROSPECTS OF DOLLARIZATION OF THE WORLD ECONOMY**

#### **3.1. Transformation of monetary policy in conditions of dollarization**

As the world's most important reserve currency and internationally traded currency, the policy changes of the US dollar have a far-reaching impact on the global economy and financial system. With the changes in the domestic economic and political environment in the United States, the US dollar policy is constantly adjusted, which brings many challenges to other countries, especially emerging market countries. As a complicated and far-reaching economic phenomenon, dollarization has a great influence on the monetary policy of a country or region. Under the dollarization condition, monetary policy is no longer confined to the management and regulation of domestic currency, but more involved in the interaction and coordination of the international monetary system. Under the condition of dollarization, all countries need to maintain a high degree of vigilance and coping ability, and the change in monetary policy involves many aspects [23, 25,56]:

The influence of the global monetary system: As the world's leading currency, the US dollar's policy changes have a far-reaching impact on other countries, especially on emerging market. Emerging market countries usually have a high degree of dependence on the US dollar, and the change of the US dollar policy has a particularly significant impact. On the one hand, the foreign exchange reserves of emerging market countries often contain a large number of US dollar assets, and the depreciation of the US dollar will cause their foreign exchange reserves to shrink; On the other hand, the debts of emerging market countries is often denominated in US dollars, and the appreciation of the US dollar will increase their debt burden. In addition, the change of dollar policy may also lead to capital outflow and financial market turmoil in emerging market countries. When the US dollar policy is tightened, international capital may quickly withdraw from emerging market countries, which will lead to large fluctuations in financial markets such

as the stock market, bond market and foreign exchange. The instability of this capital flow will not only affect the financial stability of emerging market countries, but also affect their economic growth and social stability. Although the dependence of developed countries on the US dollar is relatively low, the change in the US dollar policy will also have an impact on it. On the one hand, the change of dollar policy will affect the trade relations between developed countries and other countries, and then affect their economic growth and employment situation; On the other hand, the change of dollar policy may also lead to instability in the international financial market, which will have an impact on the financial markets and investor confidence in developed countries.

Under the dollarization condition, due to the adoption of foreign currency as the domestic currency, the power of monetary policy-making is essentially transferred to the hands of foreign central banks. This means that the central bank can no longer implement monetary policy independently by adjusting interest rates, money supply and other means. Therefore, dollarization countries often lack effective monetary policy tools to regulate and control domestic economic fluctuations. With the strengthening of the global dollarization trend, countries need to consider the independence of monetary policy, formulate monetary policy according to their own economic conditions and financial stability needs, and reduce their dependence on the dollar. This is not only the need to maintain its own economic and financial stability, but also the inevitable requirement for promoting the healthy development of the global economic and financial system. By strengthening the independence of monetary policy and other measures, countries can better cope with the challenges brought about by the change of dollar policy, promote the stable development of their own economy and finance, and help improve their status and influence in the global economic and financial system. Only by continuously strengthening international cooperation and exchanges to jointly coping with global financial risks and challenges can we promote the sustained and healthy development of the global economy and financial system.

Interest rate policy adjustment: dollarization reduces transaction costs and improves the efficiency of international trade and investment. At the same time, as an international currency, the stability and liquidity of the US dollar provide a strong financial guarantee for countries adopting the US dollar. However, dollarization is also a double-edged sword. When the U.S. economy fluctuates, countries that adopt the U.S. dollar will often be affected, and their monetary and exchange rate policies will lose their independence and have to follow the pace of the Federal Reserve. Especially when the Federal Reserve adjusts its interest rate policy, countries that adopt the US dollar will face severe challenges. If the Federal Reserve raises interest rates, countries that use dollars will have to follow suit to prevent capital outflows and currency depreciation. But raising interest rates may curb economic growth and increase the debt burden. On the contrary, if the Federal Reserve lowers interest rates, countries that use dollars may face the risk of inflation, because a large amount of dollars flowing into China will push up the price level. The Fed's policy of raising or lowering interest rates directly affects global capital flows and financial markets. High interest rates may attract capital inflows, while low interest rates may lead to capital outflows, so countries need to adjust their interest rate policies accordingly.

The Fed's high interest rate policy is usually aimed at curbing inflation, stabilizing financial markets or attracting foreign capital. When the American economy is overheated and prices rise too fast, the Federal Reserve will raise interest rates to slow down economic growth and reduce inflation. In addition, high interest rates can also increase the attractiveness of the US dollar and attract foreign investors to buy US Treasury bonds and other financial assets, thus increasing the capital inflow into the United States. However, the Fed's high interest rate policy is a disaster for other countries. Especially for those countries that use the US dollar as legal tender or main transaction currency, they have to follow the Fed to raise interest rates to prevent capital outflow and currency depreciation. This will lead to the inhibition of economic growth, the aggravation of debt burden and even the financial crisis in these countries. For example, during the Asian financial crisis

in the late 1990s, many Asian countries adopted the exchange rate system linked to the US dollar. When the Federal Reserve raised interest rates, these countries had to follow suit to maintain exchange rate stability. However, this aggravated their economic recession and debt crisis. As a result, some countries can only abandon the exchange rate system linked to the US dollar, implement a floating exchange rate system or use other currencies as legal tender.

Contrary to the high interest rate policy, the Fed's low interest rate policy is usually aimed at stimulating economic growth, promoting employment or alleviating the financial crisis. When the American economy is in recession or under the pressure of deflation, the Federal Reserve will lower interest rates to reduce borrowing costs and encourage enterprises and individuals to increase investment and consumption. In addition, low interest rates can also improve the liquidity of the US dollar and promote international trade and investment. However, the Fed's low interest rate policy may also have a negative impact on other countries. Especially for those countries that use the US dollar as legal tender or main transaction currency, they may face the risk of inflation. Because a large amount of dollars flowing into China will push up the price level and lead to an increase in the inflation rate. In addition, low interest rates may also trigger asset bubbles and financial risks. Because low borrowing costs will encourage enterprises and individuals to borrow and invest excessively, thus pushing up asset prices and increasing financial risks. In order to meet the challenges brought by the Fed's low interest rate policy, some countries have adopted different strategies. Some countries have chosen to cut interest rates with the Federal Reserve to stimulate economic growth and ease the pressure of deflation. But these countries often face the risks of inflation and asset bubbles. Other countries have chosen to maintain independent monetary and exchange rate policies to meet the challenges brought by the Fed's low interest rate policy. They reduce financial risks and maintain stable economic growth by strengthening financial supervision, improving the quality and quantity of reserve assets and promoting economic restructuring.



Diversification of international currencies: In order to reduce the risk of dollarization, countries may seek diversification of international currencies and spread risks by increasing their holdings of other monetary assets, which requires more flexibility and diversification of monetary policies. The development of diversified monetary system is helpful to reduce excessive dependence on the US dollar and enhance the economic independence of various countries. Countries can promote the development of a diversified monetary system by promoting regional monetary cooperation, strengthening currency swap agreements with other countries, and promoting the development of new monetary forms such as digital currency. This will help countries to better cope with the challenges brought by the adjustment of interest rate policy of the Federal Reserve and dollarization, and promote the diversified development of the global economy.

The necessity of international monetary diversification includes: reducing the risk of economic fluctuation, enhancing financial stability and restoring monetary policy autonomy. Diversification of international currencies can reduce the dependence of a country's economy on a single currency, thus reducing its sensitivity to economic fluctuations in the United States. By adopting multiple currencies for international trade and financial transactions, the country can spread economic risks and improve economic stability and resilience. Diversification of international currencies can reduce the exposure risk of financial markets to a single currency, thus enhancing the stability of the financial system. When a certain currency market is in turmoil, the country can reduce its risk exposure by adjusting its currency combination and avoid the financial market from being greatly impacted. Diversification of international currencies can make a country get rid of its dependence on a single currency, thus restoring its autonomy in independently formulating monetary policies. This will enable the country to adopt more flexible and effective monetary policy measures in the face of domestic economic problems and promote the healthy development of the economy.

The feasibility of international currency diversification includes: the development of a multipolar world economy, the rapid development of financial technology and the

strengthening of international cooperation. With the continuous development of the multipolar world economy, more and more countries are emerging economically and have strong international influence. The currencies of these countries are gradually internationalized, which provides more choices for international currency diversification. The rapid development of financial technology provides strong technical support for international currency diversification. Through new technologies such as blockchain and digital currency, countries can make cross-border payment and settlement more convenient, reduce transaction costs and time costs, and promote the realization of international currency diversification. With the deepening of globalization, economic cooperation among countries has been continuously strengthened. By strengthening international cooperation, countries can jointly promote the reform and perfection of the international monetary system and create a more favorable international environment for international monetary diversification.

To sum up, dollarization, as a complex and far-reaching economic phenomenon, has great influence on the monetary policy of a country or region. Under the condition of dollarization, the power of monetary policy-making is essentially transferred to the hands of foreign central banks, resulting in the loss of monetary policy independence; But at the same time, dollarization has also brought about the enhancement of exchange rate stability and the transmission of inflation. Faced with these challenges and problems, dollarization countries need to strengthen international cooperation in monetary policy, develop their own financial markets and instruments, strengthen exchange rate risk management and early warning mechanism, and improve financial market supervision system to deal with and resolve risks. Through these efforts, dollarized countries can achieve domestic economic control goals while maintaining exchange rate stability and promote sustained and healthy economic development. In order to ensure the effectiveness and stability of monetary policy, the change of global monetary system, the adjustment of interest rate policy and the diversification of international currencies should be considered

comprehensively in the monetary policy transformation under the condition of dollarization.

### **3.2. Strategic vectors of de-dollarization of the world economy**

Since the end of World War II, the dominant position of the US dollar in the global financial market has lasted for nearly 80 years. In the same time, talking about "dollarization" is not new-when the Dambray Woods system collapsed in the 1970s, when European governments introduced the euro in 1999, and when the collapse of Lehman Brothers triggered the global financial crisis in 2008, many people questioned the primacy of the dollar. Since 1980 some countries have used dollarization as a means to ward off financial crises, but the cost of dollarization is very high. Since the international financial crisis in 2008, major developed countries have faced the problem of "high debt and high deficit", and their financial situation has been deteriorating continuously. The problem of sovereign debt has caused great fluctuations in major international currencies and made the international monetary system more turbulent. The international financial crisis highlights the inherent contradiction of the US dollar leading the international monetary system. The sharp fluctuations of the exchange rate of the US dollar has a great impact on the global economy, and the voice of the reform of the international monetary system is getting louder and louder. Along with the increasingly fierce trade protectionism and the "reverse" trend of globalization, "de-dollarization" is surging in the global scope. A number of countries have launched a series of countermeasures against the strong U.S. sanctions policy and the dollar, accelerating the process of "de-dollarization" to reduce their dependence on the dollar. For non-American countries, from both political and economic perspectives, there is a willingness to move away from the dollar, and the global de-dollarization has been the general trend. Dedollarization is a choice made by more and more countries in order to safeguard their own monetary sovereignty. In the long run, the

establishment of regional currencies may be a better choice for developing countries to guard against financial risks. The study of "de-dollarization" measures in various countries or regions suggests us to follow the global trend of "de-dollarization".

The first is the Eurasian region represented by China and Russia.

Trade between China and the Russian Federation is very close. In 2023, the bilateral trade volume reached \$ 240.1 billion, an increase of 26.3% over 2022. The two sides have begun to try to agree on local currency settlement, that is, RMB against the rouble. With the sanctions imposed on Russia, Moscow is more optimistic about the RMB and actively holds and trades the RMB.

The second is Southeast Asia.

Asean is also now talking about "de-dollarisation", which would reduce reliance on the dollar, euro and the like through new currency settlements. On March 30, 2023, the finance ministers and central bank governors of 10 ASEAN countries held a meeting in Indonesia to discuss how to reduce their dependence on major currencies such as the US dollar, euro, the Japanese yen and the British pound, and instead use local currencies for trade settlement, which is an extension of the local currency settlement (LCS) plan in Southeast Asia that has been implemented among ASEAN members countries. Mr Widodo, Indonesia's president, was particularly emphatic: "Moving away from western payment systems is necessary to protect transactions from 'possible geopolitical influences'."

Third, the Middle East.

Since 2022, the Federal Reserve has ended its ultra-loose monetary policy and raised interest rates several times in a row, resulting in constant turmoil in the international financial market. Debt servicing costs are high in many Middle Eastern countries, which are challenged by high inflation, depreciating currencies and capital outflows. Experts from many countries believe that the consequences of American financial hegemony are gradually emerging in the Middle East. Some countries in the Middle East refuse to be harvested by the United States, and are exploring the road of "dollarization" by promoting

the diversification of bilateral monetary agreements and foreign exchange reserve assets. The abuse of US financial hegemony has brought turbulence to the world economy, and "de-dollarization" has become a realistic need for more and more Middle Eastern countries. Iran, Turkey and other countries have begun to explore the use of bilateral and multilateral monetary agreements for transactions settlement in international trade. Israel, Egypt and other countries are diversifying their foreign exchange reserves to further reduce the proportion of the US dollar. The currency transaction of Iranian riyal/Russian ruble has already started in the Iranian foreign exchange market. Russia has since said it will gradually abandon the dollar in its trade with Iran. To reduce the use of the U.S. dollar, Turkey and Russia negotiated a bilateral currency agreement under which Turkey would buy Russian energy in rubles and allow Russian tourists to spend their money in rubles in Turkey. At the same time, many Middle Eastern countries began to reduce their holdings of US Treasuries and diversify their foreign exchange reserves.

At the first China-Gulf Cooperation Council Summit held in 2022, China announced that it would continue to import more crude oil and liquefied natural gas from GCC countries in the next three to five years, strengthen oil and gas development and technical cooperation in clean and low-carbon energy, and settle oil and gas trade in RMB. The petrodollar system has dominated the international market for 50 years. In recent years, economic exchanges between China and Saudi Arabia have grown steadily. According to customs data, in 2021, Saudi Arabia was the largest supplier of crude oil to China, and 25% of its oil was exported to China. At the same time, China has become the largest trading partner and foreign investor of Arab countries. In 2021, bilateral trade volume exceeded US\$ 330 billion, 1.5 times that of a decade ago, and the stock of two-way direct investment reached US\$ 27 billion, 2.6 times that of a decade ago. In the first three quarters of 2022, the bilateral trade volume reached US\$ 319.95 billion, up 35.28% year-on-year, close to the level in 2021. Thus, China's demand for crude oil is still strong, and the use of RMB to settle its oil trade with China will help to expand the scale of oil trade with China. Taking RMB as the currency of oil trading is also part of Saudi Arabia's

efforts to optimize its foreign exchange reserve assets structure to get rid of excessive dependence on dollar-denominated trade. In fact, "RMB settlement of oil transactions" is not a new topic. The two countries started relevant negotiations as early as 2016 when the Saudi Crown Prince visited China for the first time. If Saudi oil is settled in RMB, it will directly weaken the dominance of petrodollars. China settled 65,000 tons of LNG from UAE in RMB for the first time in 2023. On March 29th, 2023, the Saudi Arabian Cabinet approved the decision to join the Shanghai Cooperation Organization. Since its establishment 22 years ago, the Shanghai Cooperation Organization has maintained the momentum of healthy and stable development, and successfully explored a new way for the cooperation and development of new regional organizations. The growing diplomatic relations between China and Saudi Arabia have brought a brighter future for PetroRMB. In March, 2023, The Export-Import Bank of China successfully reached the first RMB loan cooperation with Saudi Arabian National Bank [38].

Fourth, the African region.

The Pan-African Payment and Settlement System was promoted in Africa in 2022, with six countries, Ghana, Nigeria, Gambia, Liberia, Guinea and Sierra Leone, successfully testing it. According to the Vice President of Ghana, this system effectively ends the dependence of African countries on third-party currencies for cross-border payments. Under the new system, African currencies will no longer need to be exchanged for dollars, but will be traded directly in their own currencies, according to the head of the African Free Trade Zone. With more than 40 currencies in circulation in Africa, there used to be a lot of demand for dollars, but not anymore. It will be of great benefit to African smes and boost African trade and economic growth. It is an African solution to an African problem. The continent has confidence in its own settlement system. The Secretary-General of the Secretariat of the African Continental Free Trade Area said that the system could save the African continent \$ 5 billion in payment costs every year. In addition to launching their own payment and settlement systems, the Ecowas countries announced that they would issue a common currency, the Ike, in 2027.

Fifth, Latin America.

On March 30(th), 2023, Brazil announced the launch of local currency settlement between China and Brazil. In the future, bilateral trade settlement will be able to bypass the US dollar and be directly converted into local currency. In other words, trade between China and Brazil will not need to be converted into dollars. Brazil will accept RMB exchange settlement and China will accept Brazilian real exchange settlement. As the largest country in South America, Brazil signed the local currency settlement agreement with China, which will have a demonstration effect in Latin America, and Latin American countries have good relations with China and Russia. China is the biggest country in Asia and Brazil is the biggest country in Latin America. The joint announcement of local currency settlement by the two big countries is a landmark event in the dedollarisation of the world.

On March 30(th), 2023, Tesla CEO Elon Musk took to Twitter to share his thoughts on this sudden wave of global de-dollarization. "This is a serious problem," he said. "U.S. policy is so strong that other countries want to abandon the dollar. Coupled with excessive government spending, this has forced other countries to bear a large portion of our inflation."

Currency substitution is a voting mechanism with feet in the foreign exchange market. Since 2013, RMB has been engaged in frequent overseas actions, both in the settlement of cross-border trade and in the construction of the offshore RMB market, and the status of RMB has shown an obvious upward trend. But the process of internationalising the renminbi is still in its early stages. On the whole, the substitution level of RMB is not high. The reasons are as follows: First, the market-oriented formation level of RMB exchange rate is low, and there is an expectation of exchange rate changes; Second, the interest rates of local currency and foreign currencies are quite different; Third, inflation weakens the real returns of the local currency; Fourth, the continuous improvement of national income level; Fifth, the tendency of capital flight is increasing. The international community's dissatisfaction with the dollar and the enthusiasm for "de-

dollarization" have brought new opportunities for RMB internationalization. In view of the good trend of economic growth in China, RMB is expected to become a "star of the future" and a relatively strong currency in the future. "De-dollarization" cannot be simply equated with "RMB internationalization". The internationalization of RMB should stick to its own pace, gain market recognition step by step and move forward steadily.

Generally speaking, "de-dollarization" has been a general trend in the world. China, Russia, Brazil and other BRICS countries are leading the way, which will accelerate the de-dollarization. This is an important manifestation of the diversified development of the global pattern, and the world will get rid of the shackles of American hegemony more and more.

### **Conclusions to Chapter 3**

As the pilot currency of the international monetary system, every policy adjustment of the US dollar is like dropping a huge stone in the global economic ocean, causing ripples, especially for emerging market countries. Since most of these countries' foreign exchange reserves and debts are denominated in US dollars, any fluctuation in the value of the US dollar directly touches their economic security bottom line. The depreciation of the dollar has shrunk foreign exchange reserves; With the appreciation of the US dollar, the debt burden will increase, which is more likely to lead to capital outflow and financial market turmoil, threatening economic growth and social stability.

Although dollarization has promoted the efficient operation of international trade and investment and reduced transaction costs, it has also made relevant countries lose the autonomy of monetary policy in the face of domestic economic fluctuations, just like sailing in a rough sea but losing the helmsman. With the growing voice of "dollarization", countries begin to cherish the independence of monetary policy and strive to formulate realistic monetary policies according to their own economic conditions and financial security needs.

The interest rate adjustment of the Federal Reserve is affecting the nerves of the global economy. Although high interest rate helps to curb inflation and stabilize the



market, it may trigger a financial crisis for other countries. Although low interest rates can stimulate economic growth and promote employment, they may also lead to inflation and asset bubbles. Faced with the challenge of interest rate adjustment by the Federal Reserve, countries have different coping strategies. Some choose to follow the adjustment to stimulate the economy and ease the deflationary pressure, but they face the risk of inflation and asset bubbles; Others adhere to an independent monetary policy and reduce risks and maintain steady growth by strengthening supervision and improving the quality of reserve assets.

International currency diversification aims at reducing risks and increasing flexibility. It can reduce dependence on the dollar and enhance economic independence. Promoting its development through regional cooperation, currency swap, digital currency, etc. will help to meet challenges and promote global economic diversification. Its necessity lies in reducing fluctuation, increasing stability and restoring autonomy; The feasibility stems from the strengthening of multi-polar economy, financial technology and international cooperation.

The trend of dollarization in the world economy is quietly rising, especially in Europe and Asia, Southeast Asia, the Middle East, Africa and Latin America. Countries in these regions seek economic autonomy, reduce dependence on the US dollar, and strengthen regional cooperation through bilateral trade agreements and local currency settlement. Many countries in Europe and Asia promote currency transactions such as ruble and RMB, Southeast Asia strengthens financial integration within ASEAN, Middle Eastern countries explore non-US dollar pricing of oil, and Africa and Latin America seek diversified foreign exchange reserves. De-dollarization not only challenges the hegemony of the dollar, but also promotes global financial diversification and enhances the economic resilience of all countries. However, complete dollarization has a long way to go, and it requires the joint efforts of the international community to balance the interests of all parties and build a more just and reasonable international economic order.

## CONCLUSIONS

"Dollarization" is the massive use of the dollar in non-American countries and regions, so that it has all or part of the functions of currency, and gradually replace the national currency of the country. The internationalization of the US dollar may be an accident of history. Even though it achieved its dominant position in the world by occupying the "right time, geographical location and people", we cannot deny its "excellence" as "The Times make heroes". Since the signing of the Bretton Woods Agreement in 1945, the US dollar is undoubtedly the most important currency in the official foreign exchange reserves, whether it is the settlement of international payments between banks or the government's intervention in the market for the purpose of exchange rate stabilization. 1. The existence of only one major international currency is a natural monopoly, and the introduction of other currencies will increase the cost of balance of payments settlement for each country. 2. As the "bellwether" of the international currency, the US dollar has a huge absolute advantage. Once the market rules are established, banks in most countries will use US dollars as the medium of currency exchange, and the transaction cost in the market will decrease with the increase of liquidity. All banks except most banks will be attracted to using US dollars voluntarily. 3. Becoming an international currency makes the dollar a safe haven in times of economic and financial crisis, even if the crisis comes from the United States.

Just like every coin has two sides and everything has good and bad sides, the dollarization of the world economy is also a double-edged sword. On the positive side, dollarization can strengthen international trade, deepen the cooperation between some countries and the international market, and contribute to the development of their domestic financial markets. Dollarization also helps reduce foreign investors' exchange rate risk and promote overseas investment. On the negative side, for example, dollarization limits the effectiveness of monetary policy, polarized countries will lose part or all of the seigniorage, and dollarization reduces the payment efficiency (because foreign currencies

does not always meet the national payment needs). The drawbacks of dollarization seem to offset its positive effects.

With the continuous diversification of the international monetary system, the monopoly position of the US dollar has aroused the dissatisfaction of more and more countries and their financial institutions, further stimulating some countries to make dollarization a policy goal. Various events seem to have repeatedly hinted to us that "the hegemony of the US dollar is no longer, and the world currency will eventually change dynasties", and "de-dollarization" has attracted much attention from the international community. At present, the concept of "de-dollarization" is more an expression of the "victims" protest against the "dollar hegemony", a strong desire of the international community to get rid of the "dollar dilemma", and a reflection of a negative sentiment towards the dollar, which has not changed the dominant position of the dollar in essence. The "de-dollarization" of the world economy will be a long process. 1. From the perspective of economic scale, the United States ranks first in the world in terms of GDP. The United States economy has strong vitality and strong self-healing ability, and it will continue to lead the global economic growth. 2. Look at the current international status of the US dollar: if "dollarization" is regarded as a "disease" of the global economy, it is also a "chronic disease", and "de-dollarization" needs a long process. 3. In terms of alternative currencies, euro, Japanese yen, RMB or other emerging currencies have effectively stimulated competition in the international money market, greatly promote the diversified development of the international money market system, and even change the structure of official foreign exchange reserve. But none of these emerging currencies can yet surpass the dollar in absolute size.

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