Putting the Dollar in Jeopardy

For 70 years, a key element of American power has been the dollar’s standing as the world’s premier currency. But Washington’s repeated use of economic sanctions as a foreign policy weapon has encouraged China and other powers to consider financial alternatives, write Flynt and Hillary Mann Leverett.

By Flynt Leverett and Hillary Mann Leverett

Since World War II, America’s geopolitical supremacy has rested not only on military might, but also on the dollar’s standing as the world’s leading transactional and reserve currency. Economically, dollar primacy extracts “seignorage”, the difference between the cost of printing money and its value, from other countries, and minimizes U.S. firms’ exchange rate risk.

Its real importance, though, is strategic: dollar primacy lets America cover its chronic current account and fiscal deficits by issuing more of its own currency, precisely how Washington has funded its hard power projection for over half a century.

Since the 1970s, a pillar of dollar primacy has been the greenback’s role as the dominant currency in which oil and gas are priced, and in which international hydrocarbon sales are invoiced and settled. This helps keep worldwide dollar demand high. It also feeds energy producers’ accumulation of dollar surpluses that reinforce the dollar’s standing as the world’s premier reserve asset, and that can be “recycled” into the U.S. economy to cover American deficits.

Many assume that the dollar’s prominence in energy markets derives from its wider status as the world’s foremost transactional and reserve currency. But the dollar’s role in these markets is neither natural nor a function of its broader dominance. Rather, it was engineered by U.S. policymakers after the Bretton Woods monetary order collapsed in the early 1970s, ending the initial version of dollar primacy (“dollar hegemony 1.0”). Linking the dollar to international oil trading was key to creating a new version of dollar primacy (“dollar hegemony 2.0”), and, by extension, in financing another forty years of American hegemony.

Gold and Dollar Hegemony 1.0

Dollar primacy was first enshrined at the 1944 Bretton Woods conference, where America’s non-communist allies acceded to Washington’s blueprint for a postwar international monetary order. Britain’s delegation, headed by Lord Keynes, and virtually every other participating country, save the United States, favored creating a new multilateral currency through the fledgling International Monetary Fund (IMF) as the chief source of global liquidity.

But this would have thwarted American ambitions for a dollar-centered monetary order. Even though almost all participants preferred the multilateral option, America's overwhelming relative power ensured that, in the end, its preferences prevailed. So, under the Bretton Woods gold exchange standard, the dollar was pegged to gold and other currencies were pegged to the dollar, making it the main form of international liquidity.

There was, however, a fatal contradiction in Washington's dollar-based vision. The only way America could diffuse enough dollars to meet worldwide liquidity needs was by running open-ended current account deficits. As Western Europe and Japan recovered and regained competitiveness, these deficits grew. Throw in America's own burgeoning demand for dollars, to fund rising consumption, welfare state expansion, and global power projection, and the U.S. money supply soon exceeded U.S. gold reserves.

From the 1950s, Washington worked to persuade or coerce foreign dollar holders not to exchange greenbacks for gold. But insolvency could be staved off for only so long: in August 1971, President Richard Nixon suspended dollar-gold convertibility, ending the gold exchange standard; by 1973, fixed exchange rates were gone, too.

These events raised fundamental questions about the long-term soundness of a dollar-based monetary order. To preserve its role as chief provider of international liquidity, the U.S. would have to continue running current account deficits.

But those deficits were ballooning, for Washington's abandonment of Bretton Woods intersected with two other watershed developments: America became a net oil importer in the early 1970s; and the assertion of market power by key members of the Organization of Petroleum Exporting Countries (OPEC) in 1973-1974 caused a 500 percent increase in oil prices, exacerbating the strain on the U.S. balance of payments. With the link between the dollar and gold severed and exchange rates no longer fixed, the prospect of ever-larger U.S. deficits aggravated concerns about the dollar's long-term value.

These concerns had special resonance for major oil producers. Oil going to international markets has been priced in dollars, at least since the 1920s, but, for decades, sterling was used at least as frequently as dollars in order to settle transnational oil purchases, even after the dollar had replaced sterling as the world's preeminent trade and reserve currency.

As long as sterling was pegged to the dollar and the dollar was "as good as gold," this was economically viable. But, after Washington abandoned dollar-gold convertibility and the world transitioned from fixed to floating exchange rates,

the currency regime for oil trading was up for grabs.

With the end of dollar-gold convertibility, America's major allies in the Persian Gulf, the Shah's Iran, Kuwait, and Saudi Arabia, came to favor shifting OPEC's pricing system, from denominating prices in dollars to denominating them in a basket of currencies.

In this environment, several of America's European allies revived the idea (first broached by Keynes at Bretton Woods) of providing international liquidity in the form of an IMF-issued, multilaterally-governed currency, so-called "Special Drawing Rights" (SDRs). After rising oil prices engorged their current accounts, Saudi Arabia and other Gulf Arab allies of the United States pushed for OPEC to begin invoicing in SDRs. They also endorsed European proposals to recycle petrodollar surpluses through the IMF, in order to encourage its emergence as the main post-Bretton Woods provider of international liquidity.

That would have meant Washington could not continue to print as many dollars, as it wanted to support rising consumption, mushrooming welfare expenditures, and sustained global power projection. To avert this, American policymakers had to find new ways to incentivize foreigners to continue holding ever-larger surpluses of what were now fiat dollars.

Oil and Dollar Hegemony 2.0

To this end, U.S. administrations from the mid-1970s devised two strategies. One was to maximize demand for dollars as a transactional currency. The other was to reverse Bretton Woods' restrictions on transnational capital flows; with financial liberalization, America could leverage the breadth and depth of its capital markets, and it could cover its chronic current account and fiscal deficits by attracting foreign capital at relatively low cost. Forging strong links between hydrocarbon sales and the dollar proved critical on both fronts.

To forge such links, Washington effectively extorted its Gulf Arab allies, quietly conditioning U.S. guarantees of their security to their willingness to financially help the United States. Reneging on pledges to its European and Japanese partners, the Ford administration clandestinely pushed Saudi Arabia and other Gulf Arab producers to recycle substantial parts of their petrodollar surpluses into the U.S. economy through private (largely U.S.) intermediaries, rather than through the IMF.

The Ford administration also elicited Gulf Arab support for Washington's strained finances, reaching secret deals with Saudi Arabia and the United Arab Emirates for their central banks to buy large volumes of U.S. Treasury securities outside normal auction processes.

These commitments helped Washington prevent the IMF from supplanting the United States as the main provider of international liquidity; they also gave a crucial early boost to Washington's ambitions to finance U.S. deficits by recycling foreign dollar surpluses *via* private capital markets and purchases of U.S. government securities.

A few years later, the Carter administration struck another secret deal with the Saudis, whereby Riyadh committed to exert its influence to ensure that OPEC continued pricing oil in dollars. OPEC's commitment to the dollar as the invoice currency for international oil sales was key to broader embrace of the dollar as the oil market's reigning transactional currency.

As OPEC's administered price system collapsed in the mid-1980s, the Reagan administration encouraged universalized dollar invoicing for cross-border oil sales on new oil exchanges in London and New York. Nearly universal pricing of oil, and, later on, gas, in dollars has bolstered the likelihood that hydrocarbon sales will not just be denominated in dollars, but settled in them as well, generating ongoing support for worldwide dollar demand.

In short, these bargains were instrumental in creating "dollar hegemony 2.0." And they have largely held up, despite periodic Gulf Arab dissatisfaction with America's Middle East policy, more fundamental U.S. estrangement from other major Gulf producers (Saddam Hussein's Iraq and the Islamic Republic of Iran), and a flurry of interest in the "petroEuro" in the early 2000s.

The Saudis, especially, have vigorously defended exclusive pricing of oil in dollars. While Saudi Arabia and other major energy producers now accept payment for their oil exports in other major currencies, the larger share of the world's hydrocarbon sales continue to be settled in dollars, perpetuating the greenback's status as the world's top transactional currency.

Saudi Arabia and other Gulf Arab producers have supplemented their support for the oil-dollar nexus with ample purchases of advanced U.S. weapons; most have also pegged their currencies to the dollar, a commitment which senior Saudi officials describe as "strategic." While the dollar's share of global reserves has dropped, Gulf Arab petrodollar recycling helps keep it the world's leading reserve currency.

The China Challenge

Still, history and logic caution that current practices are not set in stone. With the rise of the "petro*yuan*," movement towards a less dollar-centric currency regime in international energy markets, with potentially serious implications for the dollar's broader standing, is already underway.

As China has emerged as a major player on the global energy scene, it has also embarked on an extended campaign to internationalize its currency. A rising share of China's external trade is being denominated and settled in renminbi; issuance of renminbi-denominated financial instruments is growing.

China is pursuing a protracted process of capital account liberalization essential to full *renminbi* internationalization, and is allowing more exchange rate flexibility for the *yuan*. The People's Bank of China (PBOC) now has swap arrangements with over 30 other central banks, meaning that *renminbi* already effectively functions as a reserve currency.

Chinese policymakers appreciate the "advantages of incumbency" the dollar enjoys; their aim is not for *renminbi* to replace dollars, but to position the *yuan* alongside the greenback as a transactional and reserve currency. Besides economic benefits (e.g., lowering Chinese businesses' foreign exchange costs), Beijing wants, for strategic reasons, to slow further growth of its enormous dollar reserves.

China has watched America's increasing propensity to cut off countries from the U.S. financial system as a foreign policy tool, and worries about Washington trying to leverage it this way; *renminbi* internationalization can mitigate such vulnerability. More broadly, Beijing understands the importance of dollar dominance to American power; by chipping away at it, China can contain excessive U.S. unilateralism.

China has long incorporated financial instruments into its efforts to access foreign hydrocarbons. Now Beijing wants major energy producers to accept *renminbi* as a transactional currency, including to settle Chinese hydrocarbon purchases, and incorporate *renminbi* in their central bank reserves.

Producers have reason to be receptive. China is, for the vastly foreseeable future, the main incremental market for hydrocarbon producers in the Persian Gulf and former Soviet Union. Widespread expectations of long-term *yuan* appreciation make accumulating *renminbi* reserves a "no brainer" in terms of portfolio diversification.

And, as America is increasingly viewed as a hegemon in relative decline, China is seen as the preeminent rising power. Even for Gulf Arab states long reliant on Washington as their ultimate security guarantor, this makes closer ties to Beijing an imperative strategic hedge. For Russia, deteriorating relations with the United States impel deeper cooperation with China, against what both Moscow and Beijing consider a declining, yet still dangerously flailing and over-reactive, America.

For several years, China has paid for some of its oil imports from Iran with *renminbi*; in 2012, the PBOC and the UAE Central Bank set up a $5.5 billion currency swap, setting the stage for settling Chinese oil imports from Abu Dhabi in *renminbi* , an important expansion of petro*yuan* use in the Persian Gulf.

The $400 billion Sino-Russian gas deal that was concluded this year apparently provides for settling Chinese purchases of Russian gas in*renminbi*; if fully realized, this would mean an appreciable role for *renminbi* in transnational gas transactions.

Looking ahead, use of *renminbi* to settle international hydrocarbon sales will surely increase, accelerating the decline of American influence in key energy-producing regions. It will also make it marginally harder for Washington to finance what China and other rising powers consider overly interventionist foreign policies, a prospect America's political class has hardly begun to ponder.

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Israel's 'Iron Dome' Business

The U.S. Congress is rushing to give Israel another $225 million to replenish its supply of "Iron Dome" anti-missile missiles depleted during its war with Gaza, a boost to Israel's war effort and a shot in the arm for its arms industry, as Danny Schechter explains.

By Danny Schechter

When you go to a dictionary to look up dome, you find lots of references to hemispherical structures or forms. You also find that it is slang word for the human head.

And so, it may not be much of a stretch to look at the "Iron Dome" counter-missile system utilized by the Israeli forces as a perfect metaphor for the men authorizing its deployment and use, the iron domes of the heads who head up Israel's military, and orchestrate its most assuredly not defensive war against Gaza.

It is also a metaphor for the war itself. The finger pushing reliance on computer technology, whether with domes or drones, tends to block all sensitivity of the human costs and consequences.

CNN reports that, “Israel uses Iron Dome to block rockets from striking its major population centers. It targets incoming rockets and fires an interceptor missile to destroy them in the air. The Israeli government says Iron Dome has intercepted more than 400 rockets fired from Gaza since the conflict broke out in early July.”

Newsweek adds that it is not a perfect system, “Israeli and U.S. officials have said Iron Dome systems are responsible for shooting down more than 90 percent of the rockets they have engaged, while ignoring missiles on a trajectory to fall wide. That accounts for about a fifth of the rockets Israel has said militants have fired into the country during the latest crisis.”

(Interesting about this paragraph is that it does not mention that as an occupying power, Israel has an obligation to protect the people in Gaza. It also does not mention Hamas, a political party/movement, but refers only to “militants,” many of whom are Palestinians who fled Israel, the country now pulverizing Gaza.)

If true, that means that only a fifth or 20 percent of the missiles fired have been intercepted, a fact that is at variance with the impression Israel fosters about the precision nature of its technology. Also, missing from most of the coverage is the fact that the United States poured nearly a billion dollars into building the project.

Foreign Policy reported in July *before* Israel invaded Gaza again: “Iron Dome, the anti-missile system that is seen as so successful at preventing Hamas’ rocket attacks from being effective that it is credited, in part, for having kept Israeli troops from mounting a ground invasion of Gaza, is getting major new funding from Congress. The infusion of cash will radically bolster the program even if can’t guarantee peace in the region — even in the short term.”

FP’s Kate Brannen: “The additional money for Iron Dome cleared one of its final hurdles Tuesday, when a key Senate appropriations subcommittee unanimously voted to double the Pentagon’s $175 million request for fiscal year 2015. The full committee will consider the defense appropriations bill on Thursday. Meanwhile, three other panels have already signed off on the funding expansion, making it all but certain the additional money will be provided. Iron Dome has received $720 million in American funding since 2011, when the United States became directly involved in the program.”

Of course, the Dome did not stop Israel’s dome-heads from invading Gaza, but it may be playing another mostly unreported role, argues Samer Jaber, a former Palestinian political prisoner who graduated from Brandeis and studied at Harvard and MIT, speaking on Al Jazeera:

“Reporting on the Dome has provided near-real time televised war coverage. The media has repeated statistics demonstrating its success rates – although there appears to have been a reluctance to scrutinize official Israeli figures and an absence of voices from those who might question its effectiveness.

“It is understandable that Israeli officials would want to promote the idea of the Dome’s success. It gives the Israeli public a sense of safety and security. It demonstrates that the state is fulfilling one of its commitments to its citizens – the duty to protect.

“But it is undeniable that this unquestioning tone helps provide a certain marketing messageFollowing Operation Pillar of Defense, launched against Gaza in November 2012, seven nations, including the United States and South Korea, expressed interest in buying some variant of the Iron Dome system. As the Israeli economy depends on the sale of weapons and other military equipment, this latest round of war on Gaza is another opportunity for Israel’s weapon consortium to boost its business around the world.”

One reason for the timing of this Gaza invasion may be that sales of the Dome may soon have lower-cost competition, thanks to hacking, allegedly, by a cyber-war crew from China.

RT reported: “In addition to taking information on the Iron Dome, the attackers were also able to nab plans regarding other projects including Unmanned Aerial Vehicles, ballistic rockets, and ‘detailed schematics and specifications’ for the Arrow III missile interceptor.

“According to independent journalist Brian Krebs, the intrusion occurred between 2011 and 2012 and was carried out by China’s infamous ‘Comment Crew’ a group of cyber warriors linked to the Chinese People’s Liberation Army (PLA).”

Chinese hacking is not unique in looking for short cuts to commercial applications. The underlying technology is not all Israeli either, with Boing credited with developing missile targeting.

The political and military costs have to be factored in as well: Again, Foreign Policy: “Israel is reporting that Iron Dome has had a 90 percent success rate, though it has only been used against 27 percent of the Hamas rockets. Because of the high cost of each interceptor – which the Washington Post pegs at roughly $20,000 a piece – Israel only uses the system when its radars indicate that a

rocket seems likely to hit a populated area. The Hamas rockets are thought to cost less than $800 each."

Note, how the statistics in all of these articles supplied by the salesmen/generals behind the Dome marketing effort differ from publication to publication.

It's also significant that Israeli propagandists seem to now be dropping their focus on the threat of missiles by focusing instead on "Terror Tunnels" as their more visible media talking point. Of course they don't reference the tunnels in Warsaw that enabled some Jews to escape the Nazis, or the Cu-Chi Tunnels in Vietnam that allowed resistance fighters to hide from the savage bombing of U.S. napalm and Agent Orange and other war crimes.

Noura Erakat debunks these Israel's talking points on Gaza in The Nation: "Israel claims that its current and past wars against the Palestinian population in Gaza have been in response to rocket fire. Empirical evidence from 2008, 2012 and 2014 refute that claim."

She argues that diplomacy that led to a "lull arrangement" was what stopped missile attacks, as confirmed by a press release of the Israeli Ministry of Foreign Affairs at the end of July in 2008:

"During its first month, the lull arrangement resulted in a significant drop in rocket and mortar fire at Israel. A relative calm has settled over Sderot and Israeli population centers near the Gaza Strip, occasionally broken by rockets and mortar bombs fired by terrorist organizations which oppose the lull (mostly local Fatah networks, with the Palestinian Islamic Jihad violating the lull only on one occasion)."

Jaber's final point merits a media investigation as well: "Israel's intransigent approach to the political issue of the colonization of Palestine – whereby it employs security solutions rather than working towards a political settlement – may in some part be explained by the Iron Dome's profitability."

War has always been about business, just as the constant propaganda use of the Holocaust itself as the subtext is often denigrated as "Shoah business" by critics of Israel's reliance on fear-mongering as a way of raising money and support while disguising offensive warfare as defensive action.

Dome-heads in Tel Aviv now have orchestrated their legions of often empty-minded cult-like bi-partisan dome-head supporters in Congress backed not just by Jewish groups but right-wing evangelical Christians for Israel who are trying to silence all debate about the massive killing of civilians in Gaza, despite all their rhetoric about curtailing government spending and the sad state of the

U.S. economy.

Their mantra is now built around the Iron Dome show with its underlying arrogance: See how clever we are!

The media does its bit by blaming the war on the resistance to the war and, then, refusing to investigate and report on massive spending to fund Israel in an atrocity that shows how domed their own consciences are.

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