The Beginning of the End of the Petrodollar: What Connects Iraq to Iran

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Throughout history, empires and their civilizations have come and gone. During the first part of the last century, the US quietly built its empire, first in the North and Central Americas and in South America. Soon after the Second World War, the US worked to maximise the advantages it gained, and the power it assumed, between 1943 and 1945, from its victory over Germany and Japan, and as a consequence of massive Soviet casualties, and large British debt and financial burden caused by the war. The USA assumed the leading role in the Western world by, on one hand, containing the Soviet Union and preventing the spread of communist revolution beyond the borders of the Soviet bloc; and on the other hand, ensuring uncontested American supremacy within the Western world.

During the Cold War years, there was little or no challenge to the dominant position of the US in the Western world. However, with the end of the Soviet Union in 1991, the knot tying the basic objectives of the US global strategy together began to come unravelled. Once the communist danger was off the table, American supremacy ceased to be an automatic requirement of the Western system.

Since 20 September 2002, the US government has abandoned its former multilateral approach to global affairs, and adopted an imperial posture known as the so-called Bush doctrine.

The United States has long maintained the option of preemptive actions to counter a sufficient threat to our national security. The greater the threat, the greater is the risk of inaction- and the more compelling the case for taking anticipatory action to defend ourselves, (…). To forestall or prevent such hostile acts by our adversaries, the United States will, if necessary, act preemptively.1

This new agenda is based on militarist and imperial values with some theocratic overtones.2 This agenda looks much like what some people see in US foreign policy at the end of the 19th century, and the beginning of the 20th, when the US actively sought to dominate the entire Caribbean basin, Central America and even the western Pacific.

Six months after the Bush doctrine was announced, the new American doctrine was applied as a justification for an unprovoked war against Iraq by the neo-conservative
administration of the US.

Toppling Saddam Hussein’s regime without the support of the UN, and in the face of strong opposition from traditional US allies, was a clear presentation of a new unilateralist American foreign policy. The ‘regime change’ in Baghdad was not an isolated event, but only an opening salvo in a much broader neo-conservative agenda. The neo-conservatives ‘advocate a paradigm shift in which the United States spreads American values by asserting American power-by force, if necessary’. This agenda seeks to reshape American hegemonic practices according to old imperial doctrines, but with new post-colonial political and military tools.

Since 2005, there is a looming crisis brewing over Iran. In the media the phantom of Iran ‘threat’ is being amplified across the world. In order to justify a military operation against Iran, the neo-conservative rulers of the US have started a demonization campaign against this country, presenting the latest incarnation of America’s enemy, in much the same way Saddam Hussein was in the run-up to the invasion of Iraq. They have put a lot of effort into making people believe that Iran is ruled by dangerously crazy people who are trying to make a nuclear bomb, and that they would not hesitate to bomb one or more US cities. In view of such a danger, the only answer is to wage a preventive war. Speculations about possible U.S.-Israel attacks on Iran have reached a stage of war propaganda by Western media.

A recent report by the Oxford Research Group revealed that any bombing of Iran by U.S. forces, or by their Israeli allies, would result in the unnecessary death of many innocent lives. ‘A US military attack on Iranian nuclear infrastructure would be the start of a protracted military confrontation that would probably involve Iraq, Israel and Lebanon as well as the United States and Iran, with the possibility of western Gulf States being involved as well’, says the report written by Paul Rogers. The report also argues that

Military deaths in … (the) first wave of attacks against Iran would be expected to be in the thousands, especially with attacks on air bases and Revolutionary Guard facilities. Civilian deaths would be in the many hundreds at least, particularly with the requirement to target technical support for the Iranian nuclear and missile infrastructure, with many of the factories being located in urban areas. If the war evolved into a wider conflict, primarily to pre-empt or counter Iranian responses, the casualties would eventually be much higher.

Many observers view the US neo-conservative clique and its agenda as a conspiracy. This article, however, is based on the premise that they are merely part of a larger equation of global systemic structures. This view is rooted in an understanding that vested interests representing the energy, electronics, weapons, and influential segments of the media and communications industries in the US are always entrenched in key sectors of government. These interests are concerned with maintaining their privileged position. And key elements of the US economic and political elite are now responding directly to changes in global conditions that have arisen since the end of the Cold War. This is not a conspiracy. It is only business as usual.

Since the end of the Cold War, the US has waged four wars – two in Iraq, one in the former-Yugoslavia, and one in Afghanistan- and is threatening more. All this aggression is not the result of a paranoid theory, but simply a convergence of political and economic interests, travelling under the rubric of ‘war on terror’. This argument is not based on the image of a few evil people, conspiring in secret, against the people for their evil aims. However, diverging from conspiracy theory does not ignore the fact that indeed there are real conspiracies, criminal or otherwise. In particular, the US political landscape is littered with examples of illegal political, corporate and government conspiracies, such as Watergate, and the Iran-Contra scandal.

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Having said that the belief in conspiracy theories deflects attention away from the real geopolitical grounds behind the political-economic events. Conspiracy theories tend not to focus on impersonal forces like political and economic structures, geopolitical forces, market economics, globalisation, and other such abstract explanations of human events. They are based on notions that all of human history is shaped by secret societies. While real conspiracies have existed throughout history, history itself is not a conspiracy.

The economic power of the United States was in stagnation since the 1970s and is in decline since the end of the Cold War. Particularly its share of world trade and manufacturing is substantially less than it was just prior to the end of the Cold War, and its relative economic strength measured against the EU and the East Asian economic group of Japan, China and other Southeast Asian countries is similarly in retreat. The persistent use of US military power can be viewed as a reaction to its declining economic power and not merely as a response to the post-Cold War geopolitical picture. The American neo-conservative leaders see the military power of the US ‘as a trump card that can be employed to prevail over all its rivals’, and thus stop this decline.9 This is what the Bush administration is trying to achieve: to create a militarised world in which the strength of the US military forces can change and re-define the rules of the game. This is a clear goal, a specific agenda, which does not constitute a conspiracy. It is merely the way in which the system currently works, and the US administration is taking advantage of existing structural opportunities. This article is an attempt to provide primarily a macroeconomic explanation to the origins of and motivations behind the recent US policies shaped by the neo-conservative Bush administration.

American “Dollar” Imperialism

Imagine this: you are deep in debt but every day you write cheques for millions of dollars you don't have -- another luxury car, a holiday home at the beach, the world trip of a lifetime.

Your cheques should be worthless but they keep buying stuff because those cheques you write never reach the bank! You have an agreement with the owners of one thing everyone wants, call it petrol/gas, that they will accept only your cheques as payment. This means everyone must hoard your cheques so they can buy petrol/gas. Since they have to keep a stock of your cheques, they use them to buy other stuff too. You write a cheque to buy a TV, the TV shop owner swaps your cheque for petrol/gas, that seller buys some vegetables at the fruit shop, the fruiterer passes it on to buy bread, the baker buys some flour with it, and on it goes, round and round -- but never back to the bank.

You have a debt on your books, but so long as your cheque never reaches the bank, you don't have to pay. In effect, you have received your TV free.

This is the position the USA has enjoyed for 30 years.10

Since the US emerged as the dominant global superpower at the end of the Second World War, US hegemony rested on three unchallengeable pillars: 1) overwhelming US military superiority over all its rivals; 2) the superiority of American production methods and the relative strength of the US economy; 3) control over global economic markets, with the US dollar acting as the global reserve currency.

Of these three, the role of the dollar may be the greatest among equals. The US dollar is the world’s reserve currency, meaning that central banks all over the world hold huge amounts of
dollars in reserve. As a result of this situation, today America borrows from practically the entire world without keeping the reserves of any other currency. Because the dollar is the de facto global reserve currency, US currency accounts for approximately two-thirds of all official exchange reserves. America does not have to compete with other currencies in interest rates, and even at low interest rates capital flies to the dollar. The more dollars are circulated outside the US, or invested by foreign owners in American assets, the more the rest of the world has had to provide the US with goods and services in exchange for these dollars. The US even has the luxury of having its debts denominated in its own currency.

How does this work?

- The United States runs a balance of payments deficit by spending more money in other countries (buying their products, investing in them, or giving them dollars) than they spend in the United States.
- The extra dollars are held by the countries’ central banks. The banks do not ask the United States to redeem them for gold or another currency. As long as foreign banks accept and hold dollars as if they were gold, the dollars act as reserves.11

The US economy began to dominate the world economy in the early 20th century. The US dollar was then tied to gold, so that the value of the dollar neither increased nor decreased, but remained the same amount of gold. Most money was paper, as it is now, but governments were required, if requested, to redeem that paper for gold. This ‘convertibility’ put an upper limit on the amount of paper currency governments could print in order to prevent inflation. This link between paper money and gold was a product of law as well as custom. The Federal Reserve had to ensure that every dollar of paper money was backed by at least forty cents of gold. There was no tradition (as there is today) of continuous inflation. The large levels of inflation and astronomic levels of government deficits during the Great Depression, 1929-1931, rendered the support of US dollars by gold impossible. By the early 1930s, this led the US President Roosevelt to adjust the dollar/gold ratio as he saw fit.12 Until this point, the US may well have been a dominant power in the world economy, but from an economics point of view, it was not an empire. The fixed value of the dollar did not allow the US government to extract economic benefits from other countries by supplying them with dollars convertible to gold.

The American Empire was born, in a real economics sense of the term, with Bretton Woods in 1945.13 After 1945, the dollar was not fully convertible to gold, but was made convertible to gold only to foreign governments. As a result of this, the dollar established itself as the global reserve currency. No one planned this development. It came directly from the fact that the US was the dominant world power: well over half of all international money transactions were financed in terms of dollar; the US produced more than half the world output; the US also owned a large section of the gold reserves in the world. This became possible because during the Second World War, the US had supplied its allies with provisions, demanding gold as payment, thus accumulating significant portions of the world’s gold reserves. By 1945, the US had accumulated 80 percent of the world’s gold, and 40 percent of the world’s production.14

The aggressive policies of the 1960s, however, put an increasing pressure on the US dollar. The US economy experienced a cumulative reserve deficit. In particular, the dollar supply was relentlessly increased to finance America’s war in Vietnam. The US printed and spent more money than their gold reserves allowed. By 1963, the US gold reserve at Manhattan
had fallen to alarmingly low levels -- it barely covered liabilities to foreign central banks. By 1970 the gold coverage had fallen to 55%, by 1971 22%. Before the Vietnam War, the US had $30 billion in gold reserves, but it spent more than $500 billion on the war alone.\(^\text{15}\) By this time, the post-war reconstruction period had come to an end, and the European and Japanese economies had improved their economic position relative to the US, which had increased pressure on the US dollar. The strain on the US financial system became evident in 1965, when French President de Gaulle demanded gold from the US in exchange for $300 million in debt.\(^\text{16}\) The situation reached a crisis point in 1970-71 when more foreign central banks tried to convert their dollar reserves into gold. In response to a massive flight from the dollar, the US government defaulted on its payment on 15 August 1971 by cutting the link between the dollar and gold. This was because it seems that there was no choice -- the US government would not be able to buy back its dollars in gold. If governments and foreign central banks tried to convert even a quarter of their holdings at one time, the United States would not be able to honour its obligations. Hence the Bretton Woods system was ended.\(^\text{17}\)

This was a serious crisis inspired by a significant loss of confidence in dollar. As a result, the dollar was left ‘floated’ in the international monetary market, which weakened the position of the dollar as the hegemonic currency. Now the dollar had no firm backing other than the ‘full faith and credit’ of the US government. From that point on, the US had to find a way convincing the rest of the world to continue to accept every devalued dollars in exchange for economic goods and services the US needed to get from others. It had to find an economic reason for the rest of the world to hold US dollars: oil provided that reason, and the term petrodollar became the crucial link in this.

A petrodollar is a dollar earned by a country through the sale of oil. In 1972-74 the US government concluded a series of agreements with Saudi Arabia, known as the U.S.-Saudi Arabian Joint Economic Commission, to provide technical support and military assistance to the power of the House of Saud in exchange for accepting only US dollars for its oil.\(^\text{18}\) This understanding, much of it never publicised and little understood by public, provided Saudi ruling family the security it craved in a dangerous neighbourhood while assuring the US a reliable and very important ally in OPEC.\(^\text{19}\) Saudi Arabia has been the largest oil producer and the leader of OPEC. It is also the only member of the cartel that does not have an allotted production quota.\(^\text{20}\) It is the ‘swing producer’, meaning that it can increase or decrease oil production to bring oil draught or glut in the world market. As a result of this situation, Saudi Arabia practically determines oil prices. Soon after the agreement with Saudi government, an OPEC agreement accepted this, and since then all oil has been traded in US dollars.

Now why would this matter so much?

Oil is not just the most important commodity traded internationally. It is the key industrial mineral, without which no modern economy works. If you don’t have oil, you have to buy it, and if you want to buy it on the world markets, you commonly have to purchase it with dollars. Other countries buy and hold dollars like they buy and hold gold because they cannot purchase oil without dollars. This system of the US dollar acting as global reserve currency in oil trade keeps the demand for the dollar ‘artificial’ high. This enables the US to carry out printing dollars at the price of next to nothing to fund increased military spending and consumer spending.
on imports. As long as the US has no serious challengers and the other states have confidence in the US dollar the system functions. 

This has been the situation and the essential basis for the US economic hegemony since the 1970s. Needless to say, this system enables the US administration to effectively control the world oil market.

So long as OPEC oil was priced in U.S. dollars, and so long as OPEC invested the dollars in U.S. government instruments, the U.S. government enjoyed a double loan. The first part of the loan was for oil. The government could print dollars to pay for oil, and the American economy did not have to produce goods and services in exchange for the oil until OPEC used the dollars for goods and services. Obviously, the strategy could not work if dollars were not a means of exchange for oil. The second part of the loan was from all other economies that had to pay dollars for oil but could not print currency. Those economies had to trade their goods and services for dollars in order to pay OPEC.

While this has produced undeniable benefits for the US political and economic elites, it has left the US economy intimately tied to the dollar’s role as global reserve currency.

In this situation, dollars rapidly accumulated in foreign banks, particularly those serving petroleum-exporting countries. These petrodollars created an additional financial issue, because unlike Western Europe and Japan most of the oil-exporting countries had limited possibilities for domestic development and consumption. The Nixon administration responded by coaxing these countries into buying up US Treasury bills and bonds, which has since that time been the primary strategy for dealing with the US international deficits.

The end of the Soviet bloc and the emergence of a new single Europe and the European Monetary Union in the early 1990s began to present an entirely new challenge to the global position of the US power. Especially with the creation of the euro in late 1999, an entirely new element was added to the global financial system. In just a few years after this, the euro has emerged as a real alternative, establishing itself as the second most important currency in the world’s financial markets. If a significant part of petroleum trade were to use euros instead of dollars, many more countries would have to keep a greater part of their currency reserves in euros. According to a June 2003 HSBC report, even a modest shift away from dollars, or a change in the flow, would create significant changes. The dollar would then have to directly compete with the euro for global capital. Not only would Europe not need dollars anymore, but also Japan, which imports more than 80 percent of its oil from the Middle East, would have to convert most of its dollar assets to euros. The US, too, being the world’s largest oil importer, would have to hold a significant amount of euro reserves. This would be disastrous for American attempts at monetary management.

Today Americans spend 700 billion dollar a year more than they produce, so they have to borrow that 700 billion. This means that in average each US citizen enjoys $3,000 more imported products than he/ she earns. They get this large amount of money from the Central Banks of China, Japan and European countries, because they keep dollar reserves. So the rest of the world are sellers -- Japan, China, India, and the EU. The rest of the world invests, produces, exports to the US, and they lend more and more to the US. The increasing fragility of the US economy is underlined by the 2005 report from the IMF. This report pointed out that the US economy is increasingly being supported by what the IMF report called ‘unprecedented
borrowing’ from foreigners. The report went on to saying that the US deficit is unsustainable in long-term.

What does all of this have to do with Iraq and Iran?

**The 2003 Invasion of Iraq**

The interplay between the reserve currency role of the dollar and link with the oil producing countries can be observed in the recent conflict in Iraq. On 6 November 2000, while Americans were distracted by the controversial Florida presidential vote count, the Iraqi government announced that it was no longer going to accept dollars for oil sold under the UN’s Oil For-Food Programme and decided to switch to the euro as Iraq’s oil export currency – hence launching the so-called ‘secret weapon’ of Iraq. This was the first time an OPEC country dared violate the dollar-price rule. And since then, the value of the euro has increased and the value of the dollar has steadily declined. Libya has been urging for some time that oil be priced in euros rather than dollars. In 2001, Venezuela’s ambassador to Russia spoke of Venezuela switching to the euro for all their oil sales. Iran, Russia, and other countries also indicated that they would like to denominate their petroleum in euros. Since the oil trade is a central factor underpinning the dollar’s hegemony, all these are potentially very significant threats to the strength of the US economy, and US global hegemony.

The US, in alliance with Britain, intervened in Iraq militarily in March 2003, and installed its own authority to run the country. The invasion and subsequent occupation of Iraq may well be remembered as the first oil currency war. There is now a wealth of evidence to suggest that the invasion of Iraq had less to do with any threat from Saddam’s WMD programme and certainly less to do with fighting international terrorism than it has to do with gaining control over Iraq’s oil reserves and in doing so maintaining the US dollar as the dominant currency for the international oil market. In June 2003, Paul Wolfowitz, then US Deputy Defense Secretary, was asked why Iraq, which didn’t have weapons of mass destruction, was invaded, while north Korea, which claimed to have a nuclear deterrent, wasn’t. Wolfowitz said that ‘the most important difference between north Korea and Iraq was that economically we had no choice in Iraq’. There was, of course, a complex of forces and motives which impelled the US government toward war on Iraq. Among these factors, it seems to preserve the U.S. dollar as the leading oil trading currency was a leading motive -- perhaps the fundamental underlying motive, even more than the control of the oil itself.

Two months after the invasion, the Iraqi euro accounts were switched back to dollars, and it was announced that payments for Iraqi oil would be once again in US dollars only. Global dollar supremacy was once again restored. But the story does not end there. Wars often don’t work out as planned. Paradoxically, despite all these military and political advances and the rapidly increasing grip of US military power in Eurasia, for a variety of economic and political reasons, a growing number of oil producers in the Middle East, South America, and Russia are talking about openly trading oil for euros instead of dollars, or trading oil in a ‘basket of currencies’. To do so would accelerate the US dollar’s fall, and boost the euro’s claim to become the world’s second reserve currency. If a nation’s economy is only as good as its currency, and the dollar continues to lose value, the US economy would be headed for a steep fall under these conditions.
Superior military forces of the US and other Western states may take but cannot hold Iraq’s (and Iran’s) oil. Far from staving off the downfall of the US dollar, their aggression and arrogance may instead compel OPEC to ‘go euro’ en masse. Since 2001, member countries of the OPEC have sharply increased deposits in euro’s and placed less in dollars. US dollar-denominated deposits fell from 75 percent of total deposits in the third quarter of 2001 to 61.5 percent in the last quarter of 2004. During the same period, the share of euro-denominated deposits rose from 12 percent to 20 percent.

In the meantime, many people will be hurt and killed. In Iraq, for instance, ‘the civilian death toll has risen inexorably for the entire duration of the US-led military presence … following the initial invasion’. Those who have hoped that a U.S. military victory in Iraq would somehow bring about a more peaceful world must be in for a rude awakening. Figures released by the Iraq Body Count project (IBC) on 9 March 2006 show that the total number of civilians reported killed has risen year-on-year since May 1st 2003 (the date that President Bush announced ‘major combat operations have ended’). Back in February, the Bush administration renamed its ‘Global War on Terror’ to the ‘Long War’. In its Quadrennial Defence Review to Congress, the Pentagon now produced yet another hyperinflated ‘threat analysis’, claiming that the threat from worldwide Islamic militancy has escalated to a ‘generational’ time frame requiring a large-scale war of long duration fought on many fronts, hence the name change.

Déjà vu – the search for Weapons of Mass Destruction (this time in Iran)

As I write these sentences, there is a growing sense of déjà vu: in the past few months media reports have speculated that Washington is thinking an aggressive, pre-emptive nuclear bombardment of Iran to destroy the deep underground Iranian nuclear facilities. Iran may be attempting to acquire nuclear weapons, and it is undeniably clear that Iran’s newly-elected President Ahmadinejad, with his extreme nationalist demagogy, has a more confrontational policy than his predecessors, but the Iranian regime is not suicidal, considering the riches Iran sits on. And so far there is no evidence that they have come close to building nuclear weapons. Tehran has declared that it is interested solely in a nuclear power industry and insisted on its right as a Nuclear Non-Proliferation Treaty signatory to develop all aspects of the nuclear fuel cycle. On 3 October 2004, Mohammed el-Baradei, the head of the International Atomic Energy Agency (IAEA) declared that ‘Iran has no nuclear weapons programme … So far I see nothing that could be called an imminent danger. I have seen no nuclear weapons programme in Iran. What I have seen is that Iran is trying to gain access to nuclear enrichment technology, and so far there is no danger in Iran’. American officials later accused the IAEA of irresponsibility and having a lenient approach and Iran of deceit. Whether Iran is pursuing a secret weapons programme, or will in the future, is unsettled. The Bush administration, however, seems to have already made up its mind on this point. In a provocative speech to an influential pro-Israeli lobby group -- the American Israel Public Affairs Committee (AIPAC) -- on 5 March 2006, US ambassador to the United Nations, John Bolton, bluntly threatened Iran with ‘painful consequences’ if it failed to accede completely to Washington’s demands.

On 16 March 2006, the Bush administration, updating a national security strategy that laid the groundwork for invading Iraq, alleged that Iran’s nuclear threat is the biggest future challenge to the U.S. For over a year, the administration has been working on the revision of its original strategy, issued in September 2002. ‘We face no greater challenge from a single country than from Iran’, 49-page 2006 Quadrennial Defense Review says. ‘We will continue to take all
necessary measures to protect our national and economic security against the adverse consequences of their bad conduct.42 The strategy expands on the original security framework developed by the Bush administration in September 2002. That strategy shifted U.S. foreign policy away from decades of deterrence and containment toward a more aggressive stance of attacking enemies before they attack the United States.43 This is the same pattern of lies and deception with respect to the so-called ‘Iran threat’, purposefully hyperinflated so as to manipulate public opinion and the US Congress, to increase military spending to unnecessary levels and to smooth the path to war.

Whether an attack on Iran comes, by US cruise missiles or B2s or Israeli warplanes carrying US-supplied bunker busters to penetrate deep into the earth to cripple Iran’s fledging subterranean nuclear power industry, the main forces that drive the US to war will be the same as those that compelled the US, with Britain and other allies, to attack Iraq. Similar to the war against Iraq, possible military operations against Iran have very little to do with the Iranian regime’s imaginary Weapons of Mass Destruction, and they are not even only about oil. They are essentially about the political control of oil supplies on terms favourable to the US. Here ‘political control’ means not only controlling access to oil – America has large oil reserves and diversified sources from abroad -- but ensuring that oil is priced in dollars.44 Iran is about to commit a far greater offence than Saddam Hussein’s conversion to the euro for Iraq’s oil exports in 2000. The plan is not just to sell oil for euros, but also to create an exchange market for all interested parties, oil producers as well as those customers, to trade oil for euros. In mid-2003 Iran allowed for oil payments from certain EU customers to the euro, and in June 2004 announced that they were planning to begin, in March 2006, competing with the two existing exchanges -- New York’s NYMEX and London’s IPE -- with respect to international oil trades, where an euro-based international oil trading mechanism will be used.45 The NYMEX and IPE (both owned by American companies) are the places where world oil prices are fixed (in US dollars). The macroeconomic implications of an Iranian oil bourse are significant.46 If Iranian initiative becomes a successful alternative for global oil trade, the first international exchange since 1945 where buyers and sellers of oil can conduct their oil transactions using a currency other than the US dollar, it would seriously challenge the monopoly currently enjoyed by the financial centres in both London (IPE) and New York (NYMEX).47 This alternative oil bourse will consolidate the euro (petroeuro) as an alternative oil transaction currency, which will end the petrodollar’s hegemonic status as the only global oil currency.

Iran is the second largest OPEC oil producer next to Saudi Arabia. It is fourth largest in the world, after Russia, Saudi Arabia and the US. Geographically, Iran is well located for this initiative: close proximity to major oil resources of the Middle East and the Caspian Sea regions and being not far from the major oil importers such as China, India and European Union countries. Economically, Iran’s move to a euro-based system of oil transactions makes perfect sense: Iran sells 30 percent of its oil production to Europe and the rest mainly to India and China. The bourse may also lead to greater levels of foreign direct investment in Iran’s oil sector. As a result, if the decline in the dollar against euro continues, more states will increase the percentage of euros vis-à-vis the dollar they hold in reserve, which would further benefit Iran as, according to a member of Iran's Parliament Development Commission, Mohammad Abasspour, more than half of the country's assets in the Forex Reserve Fund are now euros.48
What is important for this initiative is that much demand for oil now comes from the East, most significantly from China. The real impact for global currency reserves will be felt when the immense foreign currency reserves of the People’s Bank of China, the country’s top foreign exchange lender, will one day be switched away from the dollars. Once the PBOC makes a decisive move, other central banks worldwide would follow the suit, magnifying the effects on the currency markets.

Looking ahead there are a lot of reasons why countries within the eurozone and Russia would prefer to trade oil in euros over dollars. The volatility in the US dollar and the cost of converting currencies could make petroeuros particularly attractive. Of course there are many political barriers that need to be overcome, but oil priced in both dollars and euros appears likely over time.49

One hundred years ago, the British pound was the world’s number-one currency. The pound achieved its ascendancy because Great Britain was the first modern industrialised country. The greater productivity of its industries enabled its products to displace those of the rest of the world in terms of price and quantity, and because elsewhere industrialised production was only beginning to take hold. The whole world was selling raw materials to Britain, and Britain - as the famous expression had it - was ‘the workshop of the world’. Britain's military, particularly naval, strength, and its accumulation of colonial possessions fortified the supremacy of the pound and the position of London as the world's financial centre. However this did not last forever: the development and strength of industrial production in other countries began to undermine the supremacy of British economy, and its competitors began to overtake it in terms of dynamism and productivity, and the new conditions of world economy exposed by the First World War signalled the death knell for the British pound. As a result of Britain’s soaring indebtedness during and after the First World War, the US dollar emerged first as an alternative currency and then the dominant currency. Once the dollar took over the pound it was only a matter of time before the order of things shifted. It seems the fundamental forces, that will drive the downfall of the dollar hegemony, have been building for decades, but only now may the circumstances be right for their stark manifestation. All recent indicators point out the beginning of the end for the long-standing arrangement whereby the US dollar operates as the world’s reserve currency. The question is who will take over America’s position.

The power shift to the East

A very different world is emerging. It is perhaps too early to tell whether the US and the EU will head down toward geopolitical rivalry, but the warning signs are certainly present. The rise of euro and the resulting competition with the American dollar will have geopolitical consequences. In the near future, the US and Europe are likely to engage in more intense competition over global trade and finance. A more assertive and dynamic Europe and a less competitive American economy do make it likely that trade disputes will become more politicised.

None of these political-economic trends could plausibly lead to armed conflict between the US and Europe, of course. But any one of them could result in a dramatically different world than the one we live in today.

In 20 years time, however, by 2025, America and Europe may both be spending much more time worrying about the rise of Asia than about each other. Even without a collapse of the
dollar hegemony, there seems to be satisfactory evidence for a great and rapid shift of wealth and power to China and India. The transfer of power from the West to the East is gathering pace since the late 1990s, and Washington think-tanks have been publishing thick white papers charting Asia’s, and China’s in particular, rapid progress in microelectronics, nanotech, and aerospace, and printing gloomy scenarios about what it means for America’s global leadership. The American administration considers China as a potential ‘strategic competitor’ and has exerted enormous pressure on it since the early 1990s. One flash point with the US is China’s fast growing demands for oil. China was the world’s second largest consumer of petroleum products in 2004, having surpassed Japan for the first time in 2003, with total demand of 6.5 million barrels per day (bbl/d). China’s oil demand is projected by EIA to reach 14.2 million bbl/d by 2025, with net imports of 10.9 million bbl/d.\footnote{50}

The opening up of China’s economy to global forces was part of US Cold War policy, with the intention of reaching a rapprochement with Mao Zedong in the 1970s against the Soviet bloc. How ironic that now, three decades later, the US increasingly regards a fast expanding market economy in China as a serious threat to US global hegemony. The uncertainty of the US economy and the decline of US technological leadership indicate that the time has come for the US to rethink its strategic economic options. All this may soon dramatically change the context for dealing with global economic challenges.

Today, China is the most obvious power on the rise. But it is not alone. India and other Asian states now boast growth rates that could outstrip those of major Western countries for decades to come. China is currently the world’s sixth largest economy with an annual economic growth of more than nine percent. India’s annual growth rate is eight percent. China’s economy is expected to overtake France and Britain this year, be double the size of Germany’s by 2010, and to overtake Japan’s, currently the world’s second largest, by 2020. Due to its one-child policy, China’s working-age population will peak at 1 billion in 2015 and then shrink steadily. India has nearly 500 million people under age 19 and higher fertility rates. By mid-century, India is expected to have 1.6 billion people – and 220 million more workers than China. Of course, this could be a source for instability. But a great advantage for growth if the government can provide education and opportunity for India’s masses. The experience of the last 10 years provides more optimism than problems for India in near future.\footnote{51}

China has become the engine driving the recovery of other Asian economies from the setbacks of the 1990s. Japan, for example, has become the largest beneficiary of China’s economic growth, and its leading economic indicators have improved as a result. Thanks to increased exports to China, Japan is finally emerging from a decade of economic crisis.

After China, India is emerging as an economic superpower. From outside and with just a touristic observation it is hard to tell that India is emerging as an economic giant. Jolting signs of extreme poverty abound even in the business capitals. A lack of subways, and badly designed road system, and terrible traffic. But visit the office towers and research and development centres emerging everywhere in India, and you’ll see the miracle. Indians are today playing invaluable roles in the global innovation chain. Motorola, Hewlett-Packard, Cisco Systems, and many other high-tech giants now rely on their teams in India to devise software platforms and dazzling multimedia features for next-generation devices. Intel has 2000 electrical engineers with PhDs in Bangalore designing absolutely the latest ships. Indian engineering houses use 3-D computer
simulations to produce sophisticated designs of everything from car engines and forklifts to aircraft wings for clients like General Motors and Boeing Corp.  

The post-war era witnessed economic miracles in Japan and South Korea. But neither was populous enough to power worldwide growth, or change the global game in a complete spectrum of industries. China and India, by contrast, possess the weight and dynamism to transform the 21st century global economy. The closest parallel to their emergence is the saga of the 19th century America: a huge continental economy with a young driven force that grabbed the lead in agriculture, apparel, and the high technologies of the era, such as steam engines, the telegraph, and electric lights. But in a way, even America’s rise falls short in comparison to what’s happening today. Never has the world seen the simultaneous, sustained takeoffs of two countries that together account for one-third of the world’s population.

What makes the two Asian giants especially powerful is that they complement each other’s strengths. China will stay dominant in mass manufacturing, and is one of the few countries building multibillion-dollar electronics and heavy industrial plants. The Chinese not only make textiles and cheap toys. They also make semiconductors and very advanced technology. India is a rising power in software, design, services, and precision industry. If Chinese and Indian industries truly collaborate, they would take over the world high-tech industry. These immense workforces are already converging. Thanks to the Internet and the collapse in the telecommunication costs, multinationals are having their goods built in China with software and circuitry designed in India.

One obvious reason to this shift in the balance of power in many technologies is that China and India graduate a combined more than half a million engineers and scientists a year. The total number of graduates in America is only 60,000. In three years’ time, the total number of young researchers will rise to 1.6 million in India and China together. Because these two countries can throw more brains at technical problems, their contribution to innovation is increasing fast.

Western business isn’t just shifting research work to Asia, because Indian and Chinese brains are young, cheap and plentiful. In many cases, the Asian engineers are better educated and they combine complex skills: mastery of latest software tools, a knack for complex mathematical algorithms, and fluency in new multimedia technologies. That’s true that many Western companies came to India and China for the low cost. But they are staying for the quality, and they are investing for the innovation.

What is driving innovation in Asia, however, is not the Western demand, but fast rising homegrown consumer class. China is currently the world’s third largest travel market, with 120 million air passengers in 2004. China’s passenger car market also is already third largest in the world. For instance, Volkswagen is producing more cars in China than in Germany. China has the world’s biggest base of mobile-phone subscribers – 350 million -- and that is expected to rise 600 million by 2009. With over 100 million Internet users this year, China is a dominant presence in the Internet world. In two years, China should overtake the US in homes connected to broadband. The rapid growth of Chinese Internet market has turned the country into a promised land for many Internet giants, like Yahoo, Google, MSN and eBay. Recent studies show that the attitudes and aspirations of today’s Chinese and Indians resemble those of
Americans a few decades ago. Surveys of thousands of young adults in both countries found that they are overwhelmingly optimistic about the future and believe success is in their hands.\textsuperscript{54}

The last 10 to 12 years have witnessed 3 billion people entering into what we call the global economy. From the past examples, we’re accustomed to thinking of newcomers as countries that concentrate on doing unskilled, labour-intensive tasks. What is interesting about these 3 billion people is that, while, on average, they are poor and while most of them are unskilled, there are such a large number of them, and a small percentage of 3 billion is still a lot of people. A small percentage of these 3 billion, 300 million of them are highly skilled and very well educated and ready to produce everything with the latest scientific methods. These 300 million, still a large number, as large as the US, larger than Japan, and any European country, makes a big impact on the global economy. All these have already dramatically changed the pattern of world economy.\textsuperscript{55}

Asia’s rise is just beginning, and if the big regional powers can remain stable while improving their policies, rapid growth could continue for decades. In the coming decades, how these Asian giants integrate with the rest of the world will largely shape the 21st century global order. All these powerful trends may soon be followed by increasing geopolitical strength in Asia as well.

All this should not be really surprising. Asia, and especially East Asia, was already dominant for most of human history and remained so until very recently, that is less than two centuries ago. Only then, for a number of reasons, Asian economies lost their position to the West, but it seems only temporarily. Leadership of the world system has been temporarily centred in the West, Europe and America. That shift happened in the 19th century, and another shift appears to be happening again at the beginning of the 21st, as the centre of the world economy seems to be shifting back to the East.

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This brave new post-Cold War world raises a fundamental question: will the US adapt and recapture its leadership in the world system, or will it follow Eighteenth Century Great Britain into a long and painful economic/political decline until it is eventually bailout or bought out by its former colonies?

The world today is too complicated for any single power to dominate it, and the US is trying to maintain its hegemony by relying on diminishing assets. As I mentioned at the start, hegemonic powers come and then eventually go, but the whole process of growth and decline is lengthy. History demonstrates that all global powers experience a long period of growth, followed by an equally long period of contraction. At this latter stage, they tend to become progressively more aggressive and unstable.

British imperial hegemony was over by the end of the 19th century, but it still remained an important military and economic power to be reckoned with. US power has been in decline since the 1970s, essentially because it lost some economic power in relation to others who have gained some significant influence particularly over the last 15 years. The fact, however, remains that the US is still by far the most powerful country on military political fronts and will continue to be so.
for some years yet. From its globe-girdling military bases and its world-circling spy satellites, the US keeps an eye on everything, it is everywhere and ready to intervene always. Equipped with advanced precision-guided munitions, high-performance aircraft, and intercontinental-range missiles, the US armed forces can unquestionably deliver death and destruction to any target on earth and expect little in the way of retaliation.56 ‘But US reliance on this, the … only remaining, strategy of military political blackmail can also lead to US to bankruptcy as the failing dollar pillar fails to support it as well …’57 The ‘American Century’ is ending, if it ever existed, and clinging to it as an icon is both unnecessary and dangerous: confrontation in the name of empire only encourages conflict.

A great empire is to the world of geopolitics what a great bubble is to the world of economics. It is attractive at the outset but a catastrophe eventually. We know of no exceptions.58

Notes

2 The idea that political power comes from God or Allah has recently come back in force and is being proposed, not only by Muslim fanatics, or Christian or Jewish fundamentalist religious groups, but also by the leading neo-cons. ‘Bush became a born-again Christian in the 1980s after attending a men’s Bible study group in the town [Midland – Texas], 300 miles from Dallas … “If you want to understand me, [you] need to understand Midland”, he has said.’ (S. Baxter, ‘Back in Texas They Just Know God’s on His Side’, The Sunday Times, 27 February 2005.)
3 Neo-conservatism is a political agenda that ponders on militarily enforcing an aggressive US foreign policy - “neo-conservative” is the word used by its adherents to describe their agenda. The thrust of neo-conservatism aims at US military and economic domination of the world. The word is also used quite comfortably at the American Enterprise Institute’s website. The neo-conservative writer Max Boot wrote ‘What the Heck Is a Neocon?’ in late December 2002 - an article that interestingly starts off by saying ‘the term has clearly come unmoored from its original meaning’ yet ends the article claiming that the White House's national security strategy sounds like it may have come straight from ‘the neocon bible’. (A short summary of the neo-conservative agenda can be found in the website of the American Enterprise Institute, a Washington think-tank that advises the Pentagon, http://www.aei.org/news/newsID.16723/news_detail.asp.)
7 ibid., p.9.
8 This nexus between industry, high finance, and the military, was described by President Dwight D. Eisenhower as the ‘military-industrial complex’.


13 The Bretton Woods system was an international monetary framework of fixed exchange rates after World War II. Drawn up by the U.S. and Britain in 1944. Keynes was one of the architects.


20 In 1982, OPEC adopted the ‘quota system’ to limit its oil supplies to keep oil prices at certain levels. According to this system, each OPEC country is allocated a specific level of oil production to limit total OPEC oil supply and thereby influence oil prices in the world market. This system, however, did not help OPEC to avoid the 1986 oil price collapse because most OPEC countries did not respect their quotas.


29 ‘Wolfowitz: Iraq war was about oil’, the Guardian, 4 June 2003.

30 US President George Bush has said there is no evidence that Saddam Hussein was involved in the 11 September attacks. "We have no evidence that Saddam Hussein was involved with the 11 September attacks," Mr Bush told reporters as he met members of Congress on energy legislation. … Many Americans believe that some of the hijackers were Iraqi - when none were - and that the attacks had been orchestrated by Baghdad, despite any concrete evidence to support that’ (BBC News, 18 September, 2003, http://news.bbc.co.uk/2/hi/americas/3118262.stm).


32 Iran and Russia have been building euro reserves with European gas and oil clients. Economically, it makes sense for Iran to switch gradually to euros. France, Germany and Holland are already Iran's main trading partners. In addition, many European firms are currently undertaking gas and oil exploration there. Russia is slowly introducing the euro for mainly economic reasons. Western Europe gets most of its energy from Russia, and the EU has been pushing Russia to switch from the dollar to the euro as the standard of exchange for purchasing its oil and gas exports. (Franck Perrin, ‘Oil Currency: Oil Change — will euros replace the greenback?’, Canadian Business Magazine, December 26-January 15, 2006, http://www.canadianbusiness.com/markets/commodities/article.jsp?content=20060109_193551_5296&page=2)

34 The huge and unsustainable deficits being run by the U.S. are undermining the “oil standard” that has been central to the hegemony of both the dollar and Washington for more than three decades. Relying on the dollar for energy trade will hurt Asia’s producers and consumers alike in the long run. An Asian oil market trading in European euros. Now surely that's a good recipe for a multipolar world.” (Siddharth Varadarajan, ‘India, China and the Asian axis of oil’, http://www.panjab.org.uk/english/Aoilaxis.htm, 24 January 2006.


36 Paul Rogers, Iran: Consequences of A War, Oxford Research Group, February 2006.


39 According to official US sources, Iran is likely years away from producing weapons-grade plutonium or highly enriched uranium. Vice Adm. Jacoby, director of the Defense Intelligence Agency, told the Senate Armed Services Committee in March 2005 that Iran is expected to be able to produce a weapon early next decade. According to one report, the new National Intelligence Estimate on Iran assesses that it will be ten years before Iran has a bomb. (‘Iran is Judged 10 Years From Nuclear Bomb’, Washington Post, August 2, 2005.)


44 James Fallows, ‘Will Iran be Next?’, Atlantic Monthly, December 2004, pp. 97-110. Iran may be attempting to acquire nuclear weapons. However, so far there is no evidence that they have come close to this. On 3 October 2004, Mohammed el-Baradei, the head of the International Atomic Energy Agency (IAEA) declared that ‘Iran has no nuclear weapons programme … So far I see nothing that could be called an imminent danger. I have seen no nuclear weapons programme in Iran. What I have seen is that Iran is trying to gain access to nuclear enrichment technology, and so far there is no danger in Iran’.


47 Terry Macalister, ‘Iran takes on west’s control of oil trading’, the Guardian, 16 June 2004. On 9 March 2006, Javad Vaïdi, vice chairman of the Iranian Supreme National Security Council, declared, in an addressee to AFP in Vienna that Iran ‘will not use the oil weapon for the time being because we are not seeking confrontation with other countries. But if the situation changes, we will be compelled to change our attitude and policy’. (Given in http://www.europe2020.org/en/section_global/150306.htm#8)


52 ‘A New World Economy. The balance of power will shift to the East as China and India evolve’, BusinessWeek Online, 22 August 2005,
http://www.businessweek.com/magazine/content/05_34/b3948401.htm.
54 ‘It’s Getting Hotter In The East’, BusinessWeek Online, 22 August 2005, http://www.businessweek.com/magazine/content/05_34/b3948456.htm