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Whither Dollars for Oil?

By Marcus Goncalves

Iran's upcoming New Year's Eve holiday, Nowruz, on March 20, is typically commemorated by a symbolic purging of the home and spiritual representation of creation and fertility. This year, Iran is also celebrating by changing its policy for payment of oil.

Essentially, Iran will no longer accept the U.S. dollar as payment for oil, and instead, will be looking for other currencies and commodities.

The charter of the Iranian oil bourse, a commodity exchange which opened in February 2008, calls for the commercialization of petroleum and other byproducts in various currencies other than the U.S. dollar, primarily the euro, Iranian rial and a basket of other major (non-U.S.) currencies.

While there are three other major U.S. dollar-denominated oil markets in the world, there are just two major oil bourses: the New York Mercantile Exchange (NYMEX) in New York City, and the Intercontinental Exchange (ICE) in London and Atlanta.

Iran sits on one of the largest oil and gas reserves in the world, and its plan is to develop a fourth oil market where U.S. dollars are not accepted for oil trade. In fact, Iran has proposed the creation of a Petrochemical Exporting Countries Forum (PECF), aimed at financial and technological cooperation. The British newspaper The Guardian cites Iran, Saudi Arabia, UAE, Russia, Qatar and Turkey as potential members.

This issue is not new; in the last decade a few Latin American countries, the most dollarized region in the world, began introducing measures to create incentives to internalize the risks of dollarization, the development of capital markets in local currencies, and de-dollarization of deposits, which all contribute to a decline in credit dollarization globally, but predominantly in Latin America and the BRIC (Brazil, Russia, India and China) countries.

Iran's non-acceptance of dollars for oil was first announced in 2007. At that time, Japan was the first country to comply with Iran's requirements, when it began to pay for oil in yen.

For decades, dollarization has greatly complicated the policy response in several crises and near-crisis episodes, especially for emerging economies.

The urge to “de-dollarize,” or to withdraw from U.S. Treasury bills and the dollar, is a direct result of foreign countries’ mistrust in the U.S. government’s ability to control its massive budget deficits. This arises from the fact that dollarization almost invariably undermines monetary policies conducted by foreign states’ central banks, limiting their role as a lender of last resort and creating losses in revenue from the printing and issuing of new currency.

Foreign countries are realizing that oftentimes dollarization makes them vulnerable to changes in U.S. currency policy, especially in a currency crisis. Iran’s de-dollarization intentions aside, many of the emerging economies are also considering de-dollarization.

Lately, de-dollarization seems to be picking up momentum. Last January, India held talks in Tehran to discuss alternate payment methods in the wake of the U.S. sanctions against Iranian oil exports, which appear to have only augmented Iran’s efforts to be free of the U.S. dollar. In the wake of such tensions, India is pondering whether to use gold or yen as payment for oil.

Since President Obama signed one of the most severe sanction bills against Iran into law (H.R 2194, which prohibits any person or business from investing more than $20 million in Iranian petroleum resources), Iran appears determined to phase out the dollar as a form of payment for its oil and derived products. However, if Iran follows through with its decision to refuse dollars-for-oil, it may trigger intense reaction from Washington, especially for the dollar-reserve currency, mainly supported by the Saud family’s determination to accept only dollars for oil.

The policy debate about de-dollarization, despite the U.S. and Iran conflicts, has heated up around the world. Is de-dollarization a realistic goal for the world? If so, how might it be implemented? Can Iran and other countries trigger a chain of events that may threaten to crumble the U.S. dollar status as the world’s premiere reserve currency?

What would be the consequences to the U.S., and the world economy, if the dollar were to no longer be the OPEC measure for oil prices? Certainly, we would no longer be able to brag about having the lowest prices of gasoline. The price of fuel would likely skyrocket, essentially increasing the price of all other commodities, making life for Main Street a lot more arduous than it already is.

My sincere hope is that March 20 won’t be an excuse for yet another war in the Middle East, propelled by the U.S., or by proxy through Israel, which would somehow end up inflaming tensions in the region, and at best, be a lose-lose situation for the entire world. Notwithstanding the fact that China and Russia, both formidable powers, have warned against any attack on Iran, mainly due to the massive investments both countries have in that country.

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