The Weekend Essay Life & Arts

Can the dollar remain king of currencies?

The greenback's dominance was forged on trade, alliances and institutions — now that era is at risk of alliances and institutions — now that era is at risk of drawing to a close

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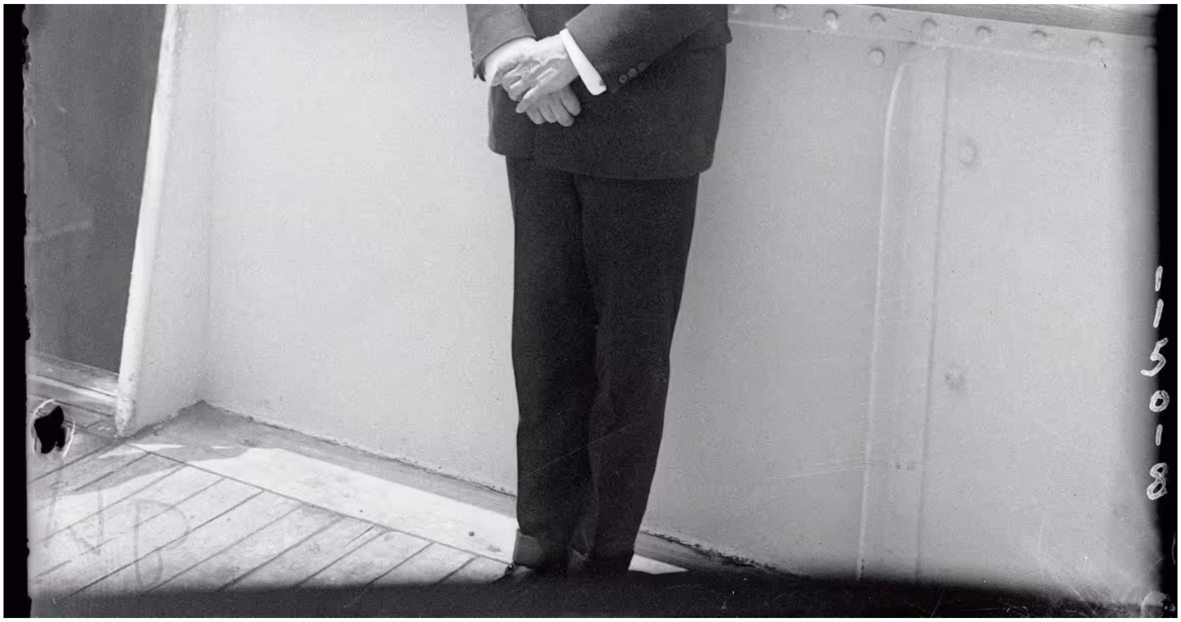
When economists seek to account for the dollar's outsize role as the only true global currency, they point to structural factors such as the US share of world GDP, or the depth and liquidity of US financial markets. This approach underlies the sanguine view of many financial market participants that, come what may, so long as the US remains the world's leading economy, the dollar will remain its safe haven.

The second Trump administration is a reminder that raw numbers can only take us so far. For as historians will tell you, it is the actions of people, not economies or markets in the abstract, that explain how international currencies rise and fall. It was people who took the crucial steps to build the institutions that made the international dollar. And it is people who will ultimately determine whether these same institutions survive or fail.



Paul Warburg, chief architect of the US Federal Reserve © Bettmann Archive

The individual with the strongest claim to patrimony of the global dollar is probably Paul Warburg, German-American scion of the Hamburg-based Warburg banking family. The young Warburg worked in international finance in Hamburg, Paris and London before marrying into the Kuhn, Loeb banking dynasty in 1895 and emigrating to the US in 1902. Extensive international experience impressed upon Warburg the advantages accruing to Britain from London's position as the leading source of trade credit and investment finance for merchants and bankers in diverse parts of the world. Those diverse parts included the US, which was almost entirely dependent on London and sterling for international credit.

Like many a naturalised citizen, Warburg was deeply loyal to his new country. He worried that the American economy's dependence on London and sterling exposed it to foreign shocks over which it had no control. He appreciated also that London's appeal as an international financial centre rested on the backstopping efforts of the Bank of England, which stood ready to act as lender of last resort, guaranteeing the market's liquidity and stability. It followed that any aspirations the US might have had to promote international use of the dollar were hamstrung by the absence of a central bank.

About the artwork

The images of the US currency in this article are from Floyd Douglas's 'Golden Dollar' series, in which the Dutch artist makes a tongue-in-cheek commentary on consumer culture with

Starting in 1906, Warburg became a tireless promoter of the creation of this institution. One of the prospective central bank's key functions, he argued, would be to develop a market in dollar-denominated credit instruments for use in financing international trade. Adopting European acrylic sculptures of gilded $1 bills

parlance, he referred to these bank drafts or bills of exchange as trade acceptances, anticipating that the central bank would "accept" or buy them as a way of lubricating the new market in trade credit.

Warburg wrote newspaper columns. He spoke at public forums, overcoming shyness born of heavily accented English. In 1910 he was part of the small group of experts who met on Jekyll Island, off the Georgia coast, to thrash out the provisions of what became the Federal Reserve Act. In 1914 he became a founding member of the Federal Reserve Board. The regulations he drafted allowed the Fed to purchase dollar trade acceptances as a way of fostering the market. By the 1920s, that market had grown to the point where the value of dollar trade acceptances matched, and in some years exceeded, the value of trade credits originated in London and denominated in sterling.

The dollar's status as a rival to sterling suffered a setback in the 1930s, when the Fed withdrew from the acceptance market and the US suffered a series of debilitating banking and financial crises. America emerged from the second world war as the western world's only superpower, creating an opening for the dollar. But it took the intervention of another singular individual, Harry Dexter White, to cement the greenback's international role.

Harry Dexter White, who drafted the plan that would become the basis for America's blueprint for the IMF, the World Bank and the Bretton Woods System © Bettmann Archive

US Treasury secretary Henry Morgenthau and China's chief delegate HH Kung at the Bretton Woods conference in 1944 © Universal Images Group via Getty Images

White came from more modest origins than Warburg. His parents were Lithuanian immigrants, his father a peddler who went on to open a hardware store. A prickly immigrants, his father a peddler who went on to open a hardware store. A prickly personality, White pursued an unrewarding academic career before joining Henry Morgenthau's Treasury Department in 1934 and rising to assistant to the secretary with full responsibility for Treasury's participation in all international economic and financial matters related to the second world war. During the war, White drafted the plan that became, with modifications, the US blueprint for the IMF, the World Bank and the Bretton Woods System, the institutions that provided the basis for the postwar international monetary order and the dominance of the dollar.

To be sure, the US had to negotiate with other countries present at the international monetary conference convened at Bretton Woods, New Hampshire, in 1944. White had to parry with his British interlocutor, John Maynard Keynes. But key elements of the White Plan went straight into the Bretton Woods agreement.

Specifically, White sought to distinguish the dollar as the only fully convertible international currency of the newly minted Bretton Woods System. An early draft of the agreement read that exchange rates should be pegged to gold or "gold-convertible currencies". When one of Keynes's colleagues, Dennis Robertson, innocently observed that only the dollar was apt to be freely convertible into gold following the war, White saw an opportunity to cement the dollar's role. He and his team stayed up all night, redrafting the agreement to replace "gold-convertible currencies" with "gold . . . or the United States dollar of the weight and fineness in effect on July 1, 1944". The Bretton Woods agreement thus singled out the dollar as the sun around which the other elements of the postwar international monetary system revolved.

The subsequent period of dollar dominance was not attributable solely to White and the institutions created at Bretton Woods. It took the Marshall Plan to provide Europe with the dollars needed to resume international payments and reintegrate its economies into the global order. US leaders had to bypass Congress's reluctance to join the International Trade Organization by agreeing to establish the General Agreement on Tariffs and Trade.

George C Marshall, the US secretary of state, at a November 1947 hearing into the plan to provide Europe with dollars © Bettmann Archive

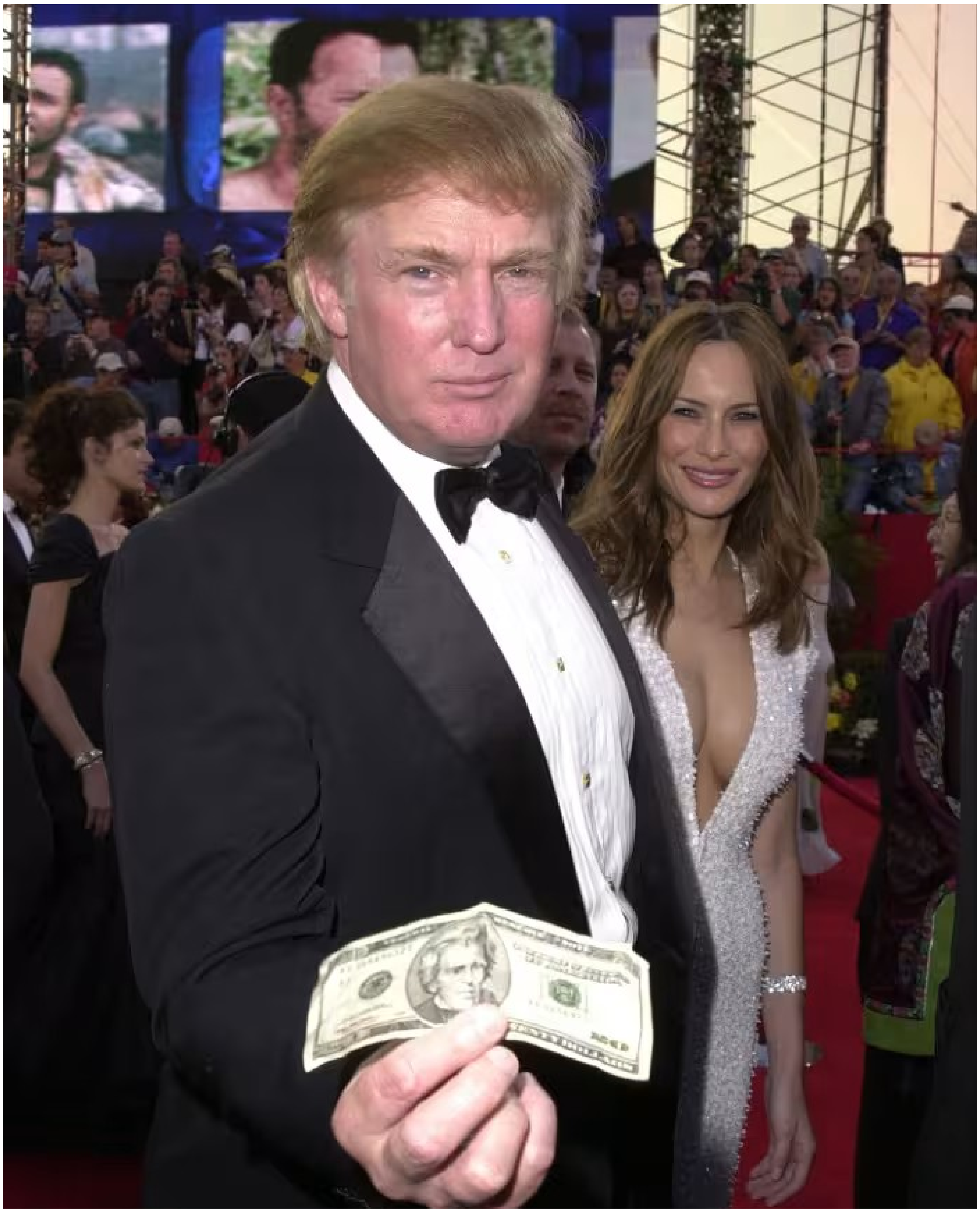
The US supported European integration and creation of the European Economic Community, a position that reassured European policymakers of the wisdom of relying on the currency of a steadfast alliance partner. Nato showed the Europeans that they had not just an economic partner but also a geopolitical partner on whose commitments — and currency — they could safely depend. Robust US growth told them that America could stand behind its obligations.

Thus, even when the Bretton Woods System of exchange rates pegged to the dollar broke down in 1971, the greenback's global centrality lived on, supported by the institutions built by Warburg, White and their compatriots: an independent Federal Reserve, an open world trading system to which the US and its partners were committed, and a rock-solid geopolitical alliance. The dollar's continued dominance derived from sheer numbers — from the US's large share of global GDP and financial transactions — but equally from relationships and reciprocity.

It has taken Donald Trump only a few months to weaken if not destroy those relationships and that reciprocity. Trump and his appointees question the very values and arrangements on which nearly a century of dollar dominance is based. For the first time in living memory, the survival of the institutions on which that dominance rests has been cast into doubt.

To start, America's economic exceptionalism is in doubt. The US economy has outperformed those of other advanced countries in recent years. It is home to the world's leading tech companies. It is at the forefront of research in artificial intelligence. It has a start-up-friendly culture where serial entrepreneurs are forgiven their failures, and a well-developed venture capital industry to seed new enterprises. It is a magnet for foreign talent.

But there is no guarantee that what was true in the past will be true in the future. The research capacity of the public sector and US universities is being gutted. Whether skilled migrants will still see America's pearly gates as welcoming is an open question. Policy uncertainty and doubts about rule of law threaten to make America a less attractive place to invest.



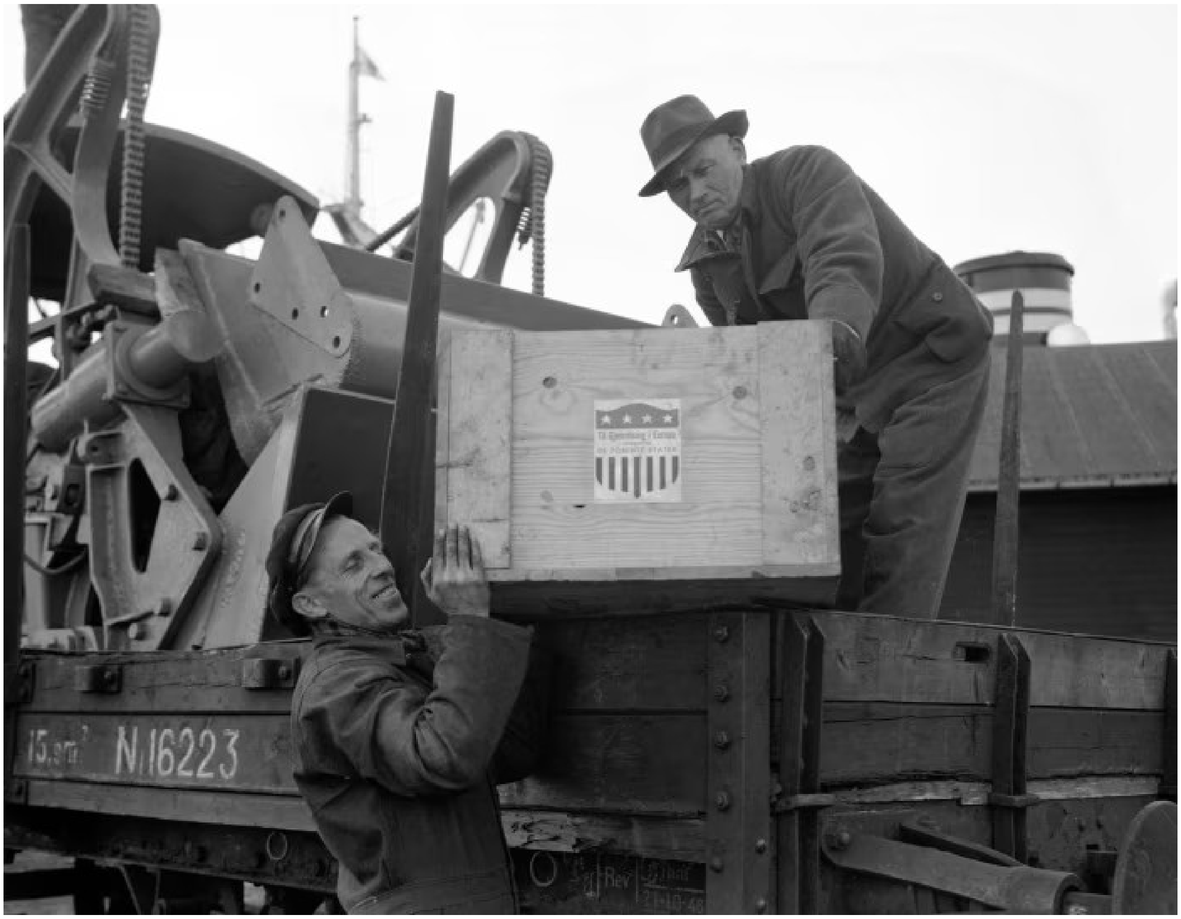
Donald Trump with Melania at the Academy Awards in 2001 © WireImage

The US share of global exports has fallen significantly since the early 1950s, from 18 per cent to just 11 per cent. There is nothing unhealthy about this trend in and of itself. It reflects successful post-second world war reconstruction of the global economy, a process in which America had a considerable hand. But a further decline in the US share of global trade, engineered by skyscraper tariffs imposed by politicians convinced that international trade is a zero-sum game, would be decidedly unhealthy. History is replete with examples of how a country's commercial links support international use of its currency — and how disruption of those links undermines a currency's international status.

It is easy to see why. The currency of the leading trading nation is a natural habitat for its exporters and importers, who loom large in global markets. There is then an incentive for exporters and importers elsewhere, when seeking to do business with this major economy, to similarly utilise its currency, given its convenience for their customers and suppliers. The incentive is similar for foreign entities seeking to borrow on this dominant country's financial markets. Consequently, when the weight of an economy in global trade and finance declines, the market forces making for widespread use of its currency have a corresponding tendency to weaken. A perverse "America First" tariff policy destructive of US trade would accelerate this process.

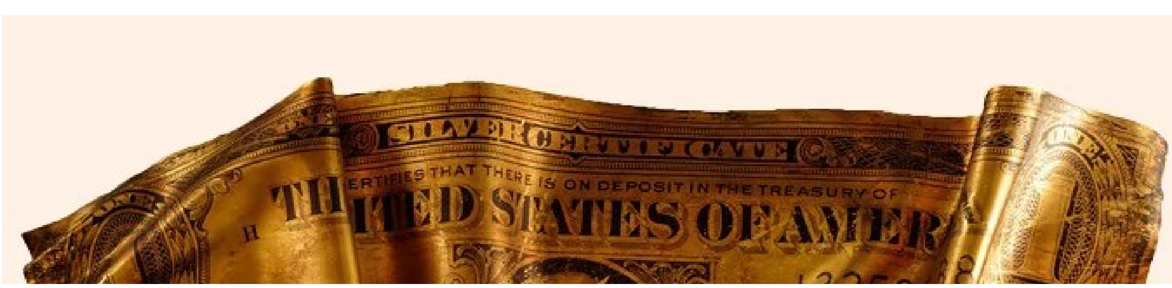
In addition, there is a danger to the dollar from haphazard US use of sanctions. Even before Russia's attack on Ukraine and sanctions on Russian entities, America had increasingly turned to this financial weapon: the number of individuals subject to US sanctions had risen from 912 in 2000 to more than 9,400 in 2021. Sanctions imposed on Russia in 2022 sharpened the incentive for countries to hedge their bets by diversifying away from the dollar, given the possibility that Russia's dollar assets might not only be frozen but also garnished and repurposed for Ukrainian reconstruction, setting a precedent for what other countries could suffer.

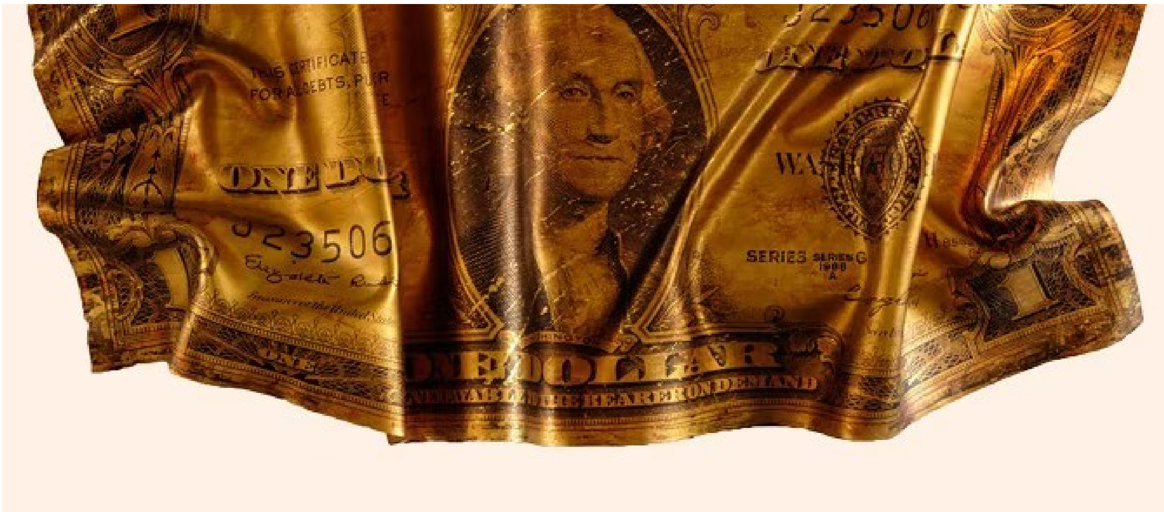
Importantly, however, those sanctions were imposed in co-operation with America's allies, leaving the Russian government few alternatives to the dollar for use in international payments. But here too, past may not be prologue. European countries were not on board with the first Trump administration's policy of "maximum pressure" on Iran and its reimposition of sanctions against the country.



Workers unloading boxes in Oslo as part of the reconstruction of Europe aided by the Marshall Plan after the second world war © Alamy

The decline of transatlantic co-operation in Trump's second term points to the high likelihood of more such disagreements. Trump has not exactly been cautious in threatening to unleash economic weapons, be they tariffs, sanctions or other measures. When applying them, he has not co-operated with other countries — quite the contrary. If the US continues to go its own way, then the currencies of other countries, those that do not participate in US sanctioning efforts, will be the beneficiaries of diversification away from the dollar.





Then there is America's troubled fiscal and financial outlook. The dollar has been attractive to central banks as a form of foreign reserves, and to corporate treasurers, sovereign wealth fund managers and international investors generally, because it is available in ample amounts while still holding its value. The US has provided a steady supply of dollars to meet the liquidity needs of an expanding world economy without supplying so many as to erode confidence in their value.

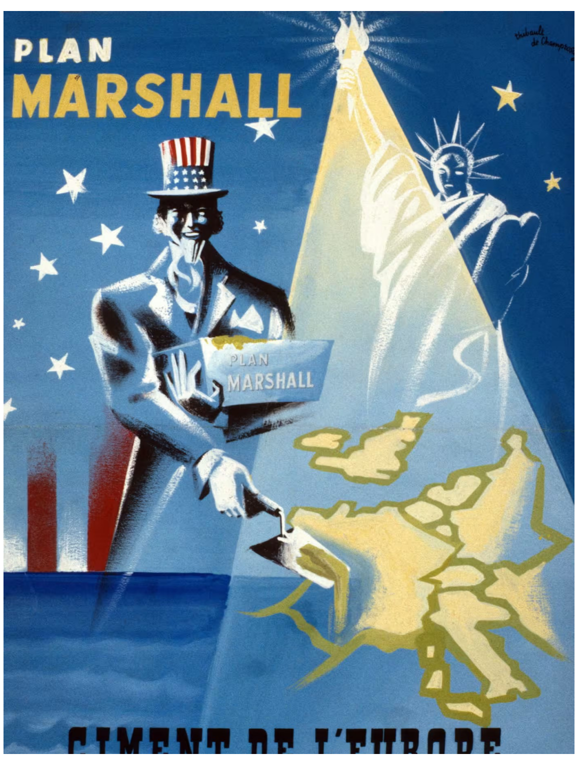
But if this has been true until now, US fiscal and financial woes could, in the not-too-distant future, push the dollar over the edge. The Congressional Budget Office's long-term budget outlook shows debt in the hands of the public rising from 99 per cent of GDP in 2024 to 116 per cent in 2034, 139 per cent in 2044 and 166 per cent in 2054. Impending legislation, including measures that extend Trump's expiring 2017 tax cuts, could push debt up even faster. There is no magic debt-to-GDP threshold where confidence is automatically lost. But endless tax cuts, mythical expenditure reductions and high levels of political polarisation will at some point cause foreign investors to doubt the dollar's prospects.

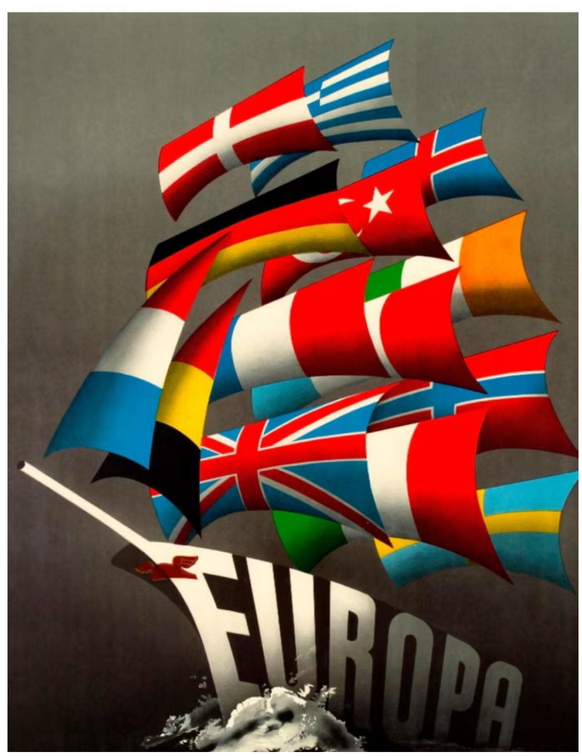
If dollars are an attractive store of value and means of payment because they are expected to hold their value, then steps by the Trump administration to undermine the independence of the Federal Reserve would seriously damage the greenback's attractions. In February, Trump signed an executive order asserting that "officials who wield vast executive power must be supervised and controlled by the people's elected president". He instructed all "so-called 'independent regulatory agencies'" to submit their regulatory proposals for review by the White House prior to enactment. His acting solicitor-general, Sarah Harris, asserted to the Senate that the Department of Justice would no longer defend provisions requiring the president to cite "cause" when dismissing an independent agency head.

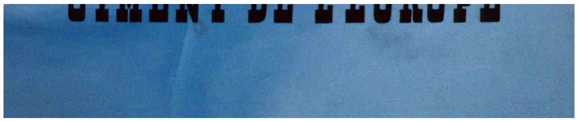
It is unclear whether such orders will ultimately be invoked to challenge the independence of the Fed or the security of Jay Powell's appointment as chair. But Trump has just fired the two Democrat members of the independent Federal Trade Commission. Foreign investors will draw their own conclusions.

There are questions, moreover, about whether foreign holders of US debt securities will continue to be treated fairly. Scott Bessent, Trump's Treasury secretary, has reportedly mulled the possibility of converting five- and 10-year US treasury bonds held by foreign investors into 100-year securities bearing low interest rates, whether those investors like it or not. During the 2024 presidential campaign, advisers to Trump such as Robert Lighthizer mooted the possibility of taxing foreign purchases of US treasuries as a way of driving down the dollar and enhancing the competitiveness of US exports.

Trump's nominee to head his Council of Economic Advisers, Stephen Miran, in his earlier incarnation as investment strategist, endorsed such a policy and described how it might be implemented. Miran proposed slapping a "user fee" on foreign official holders of treasury securities by withholding a portion of their interest payments. Labelling the measure a user fee instead of a withholding tax would avoid violating international tax treaties. But it would fall foul of the expectation that domestic and foreign investors are to be treated comparably, an expectation that is a foundation stone of the dollar's international status. This effort to limit foreign purchases of US treasuries as a way of depreciating the dollar, something that Trump and his advisers evidently see as desirable, could quickly get out of hand.







A 1947 poster showing Uncle Sam rebuilding the continent with the Marshall Plan above the slogan 'Cement for Europe' in a design by Thibault de Champrosay © Cirip collection

A vintage 1950s poster by Dutch artist Reyn Dirksen to publicise the Marshall Plan with the theme of co-operation and economic recovery © Alamy

Finally, the dollar's global role will suffer if the US is perceived as turning its back on its allies. Countries hold as reserves and use in international payments the currencies of their alliance partners. Not only are those partners seen as reliable stewards of their foreign balances, but holding the currency of one's ally is taken by the partner as a sign of good faith. Before the first world war, members of the Triple Alliance (Germany, Austria-Hungary and Italy) and the Triple Entente (France, Britain and Russia) held as foreign reserves the currencies of their alliance partners. Still other countries held as reserves the currencies of countries with which they had security understandings.

In the 1930s, not only the Commonwealth and Empire but also a fair number of Britain's other allies held their reserves in London and pegged their exchange rates to the pound in the arrangement known as the Sterling Area. In the 1960s, the German and Japanese governments supported the dollar, helping to preserve its international currency status, because of the value they attached to their defence alliance with the United States, and specifically to US military forces stationed on their shores. Today, Taiwan, South Korea and Japan hold a disproportionate share of their foreign reserves in dollars because they depend on the US security umbrella. In the wake of Trump's Oval Office blow-up with Volodymyr Zelenskyy and appeasement of Russia, this notion that alliance politics are important for international currency status is about to receive a real-time test.

Ultimately, the fate of the dollar will turn on the willingness of America's leaders to uphold the rule of law, respect the separation of powers and honour the country's commitments to its foreign partners. It will depend on the readiness of Congress, the courts and the public to hold their feet to the fire. Who would have thought it would come to this?

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