The international monetary and financial system: a fork in the road

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Abstract

A US-centric, dollar-based international monetary and financial system (IMFS) was inevitable in the immediate postwar decades considering prevailing economic conditions and the institutional arrangements made at Bretton Woods. But while some predicted that the end of the Bretton Woods system in 1973 would bring a more symmetric IMFS, the United States has remained central until now, and the dollar still reigns supreme. The US administration in power since January 2025 is taking a different fork in the road, basing its international policies on the premise that current global trade, financial and geopolitical arrangements have unfairly disadvantaged America. Coupled with domestic institutional erosion within the United States, that approach, if pursued without compromise, would recast the IMFS by fragmenting financial markets and diminishing the dollar's central role.

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The post-World War II international monetary and financial system (IMFS) has evolved considerably over its 80-year lifetime, but its foundational idea that trade facilitates mutual prosperity has been a constant driver. In an insightful 2009 speech, Andrew Crockett identified three key components of the system: the underlying economic framework for international monetary and financial relations, the institutional arrangements under which those relations are conducted and the distribution of governing power.[2] Crockett viewed the IMFS as having evolved from a primarily government-led structure based on fixed exchange rates and limited private capital mobility to a more market-led order with a key role for cross-border finance. Considering the Great Financial Crisis of 2007–08, however, Crockett thought the IMFS needed reform. His preferred direction of movement was towards more global cooperation in addressing financial risks and accidents, through processes that allow "all participant countries to feel their views are adequately taken into account".

In the years after the financial crisis, the global community moved partially in this direction. In doing so, it displayed an adaptability that has, up until now, been a notable feature of the postwar IMFS experience. The capacity to adapt relied on a broadly shared positive sum view of global economic prosperity. It also relied on the willingness of the system's key sponsor, the United States, to provide key global public goods, crucially including public goods related to international security. That willingness has waxed and waned but until now has never been entirely repudiated.

Today, though, the nationalistic rhetoric and policies of the new US administration are poised to drive a tectonic shift in the IMFS. While Crockett in 2009 saw global financial instability as the major threat, the Trump administration's grievances involve financial markets mainly insofar as they have enabled America's foreign trade deficits, which have coincided with declining manufacturing employment. Based on a myopic view of the causes of trade deficits, President Trump's main direct assault on global commerce up until now has been through tariffs. Nonetheless, the trade war, allied with a range of other US policy changes, will likely promote financial as well as trade fragmentation in the years ahead if not tempered through multilateral compromise. The IMFS has come to a fork in the road: reversion to economic conditions more like those the postwar system was intended to avoid is not hard to envision. The potential collapse in multilateralism extends beyond trade and financial arrangements, of course, at a time when the world faces other, more deadly, challenges to collective action.

I will start today by outlining the main features of the international monetary order designed at Bretton Woods in 1944 and the increasingly difficult trade-offs US policymakers faced as the system's main steward in the years leading up to the system's demise over 1971–73. My point is that the tension between US national goals and global stewardship is nothing new. Out of the chaotic conditions of the 1970s, however, a revised IMFS emerged as all three of Crockett's components advanced: the scope of international markets, the institutions governing international transactions and the distribution of power in the system. Despite the setbacks of periodic financial crises, the revised system, viewed from 30,000 feet, did remarkably well over a half century in promoting the central goals of the Bretton Woods founders. The US remained the essential

[2] Crockett (2010).

hegemonic power, and the dollar, contrary to some expectations in the early 1970s, only solidified its position as the leading international currency.

Success from a 30,000-feet perspective did not translate into political harmony at the domestic level, especially in the richer countries that were early beneficiaries of the postwar IMFS. As an economist and not a political scientist, I will stick to my comparative advantage and not delve too deeply into the causes of the global resurgence in nationalism and anti-democratic tendencies, where no one-size-fits all theory applies to all countries. Structural economic changes, partly but not mostly linked to globalisation, have surely played a role, as have governments' responses (or non-responses) to those changes. Generally lower growth since the Great Financial Crisis has accentuated the adverse turn of politics, as have immigration pressures driven by economic and security shocks in lower-income countries. But for today I will take as given that the central player in the IMFS, the United States, has made a hard and perhaps durable pivot towards assertive nationalism in its domestic politics and foreign economic relations. This has profound implications for the system and the reigning hegemonic currency, the US dollar.

Pressures of the Bretton Woods years

The Articles of Agreement of the International Monetary Fund (IMF), agreed to on 22 July 1944, set out the basic blueprint for the postwar IMFS. According to Article I, the agreement has six purposes, but the most fundamental of these, which the other five support, is in paragraph (ii): "To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy."[3]

To achieve this goal, the 1944 blueprint mandated fixed exchange rates, adjustable in cases of "fundamental disequilibrium", and featured IMF lending as key liquidity support to finance temporary balance of payments deficits without unnecessarily harming employment and growth. Private capital movements, viewed as having been a largely destabilising force in the 1930s, remained highly restricted and were not relied on for balance of payments financing.

John Maynard Keynes opposed an asymmetric role for the US dollar within the new system; in contrast, the US negotiator, Harry Dexter White, stated in 1943: "The dollar is the one great currency in whose strength there is universal confidence. It will probably become the cornerstone of the postwar structure of stable currencies."[4] White's vision won out, and Article IV of the 1944 agreement allowed countries to express par values for their currencies in terms of US dollars (albeit dollars of the statutory gold weight and fineness in effect on 1 July 1944). Undoubtedly, the dollar would de facto have become central to the system in any case considering America's size in the world economy (Graph 1) and its commanding military reach. What the dollar's centrality

[3] Reproduced in Lamoreaux and Shapiro (2019, p 275).

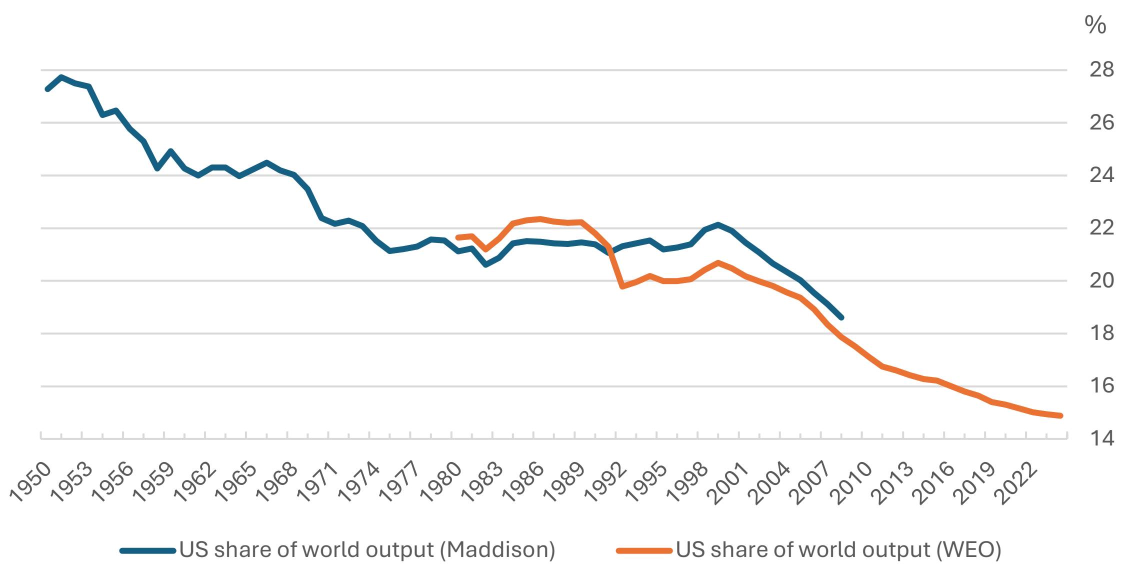
[4] Van Dormael (1978, p 200).

meant in practice was that, with *N* currencies of IMF members and therefore only *N* – 1 exchange rates, the United States enjoyed the "exorbitant privilege" of having no responsibility itself to intervene in foreign exchange markets. Foreign monetary policy autonomy was constrained by the obligation to stabilise the dollar exchange rate. In contrast, the United States had a freer hand in its own domestic monetary policy and an outsized ability to influence global monetary conditions. Another asymmetry: the large US share in IMF resources gave it, uniquely, a veto on the Fund's Executive Board.

While Article I does not explicitly mention "price stability", the United States had a critical obligation that amounted to providing the system's nominal anchor: it was to stand ready to redeem foreign official dollar holdings in gold at a price of $35 per ounce. As the world recovered and those holdings grew, the gold commitment became problematic.

Eichengreen (2019) calls the US gold commitment the "original sin" of the Bretton Woods system. It gave rise to the fear, highlighted by Triffin (1960), that the US gold stock would be inadequate to cover foreign official liabilities, inevitably sparking a run. As foreign authorities' dollar holdings grew (Graph 2), the gold convertibility obligation increasingly bedeviled US policy. Between the late 1950s and 1971, it generated an ever-starker trade-off between the policy agendas of successive US presidents and the country's international promises.

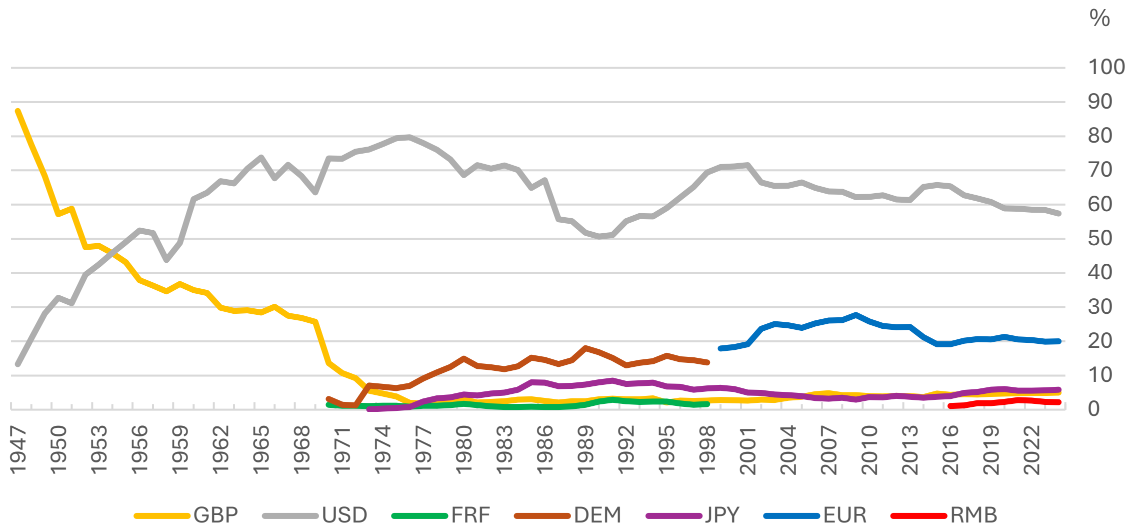
US share of world GDP at purchasing power parity, 1947–2024 Graph 1



In both databases, former Soviet bloc countries enter the country sample in the early 1990s.

Sources: Maddison Database, 2010; IMF, World Economic Outlook database, April 2025.

Major currencies' shares in global foreign currency reserves, 1947–2024 Graph 2



Reserves are measured at current exchange rates.

Source: Chiţu-Eichengreen-Mehl Global Currencies Database, based on Eichengreen et al (2017), globalcurrenciesdatabase.com/publications-datasets/, accessed 4 June 2025.

Triffin's diagnosis is questionable: even at the time, Kindleberger (1965) contended that short-term dollar liabilities were providing crucial liquidity to foreign holders while allowing the United States to invest in higher-yielding assets abroad. Like a well run bank, the United States faced no inevitable run, though it could have fallen prey to capital flight fuelled by misinformed economic narratives.[5] Unfortunately, sound "bank management" practices went by the board during the Lyndon Johnson and Richard Nixon presidencies. Fiscal pressures led to rising inflation, an intimidated Federal Reserve failed to contain the inflation, and US trade partners suffered the consequences.

A dollar devaluation might have helped the US balance of payments, but the dollar's asymmetric position meant the US could not unilaterally devalue against foreign currencies: foreign countries would have to revalue *their* currencies if the dollar was to become relatively cheaper. Faced with destabilising capital flows and an upcoming re-election campaign, President Nixon in August 1971 (without first consulting allies) ended the US gold redemption commitment and imposed a 10% surcharge on all dutiable imports, to be lifted only after a generalised revaluation against the dollar was agreed to. The resulting Smithsonian Realignment failed to stabilise markets. By March 1973 major currencies were floating against the dollar and a new chapter in the IMFS began.

5 For further discussion, see Bordo and McCauley (2019). In Obstfeld (2014) I observe that the Triffin problem was essentially one of fiscal solvency: the United States could have purchased more gold to cover its obligations but would have sharply bid up the world price. France was prominent in converting dollars into gold starting in the mid-1960s, deploying cargo jets to fly the gold from New York to Paris (Avaro 2022). Even in early August 1971, France announced a substantial conversion. The effects are evident in Graph 2.

Nixon's actions had a distinct "America first" flavour, but in contrast to the current trade war that President Trump has launched, Nixon's actions (however dramatic) were limited and there was a clear "ask" – a generalised currency realignment – with a realistic endpoint. US trade partners were not happy with Treasury Secretary John Connally's dictum, "It's our dollar, but it's your problem," but they recognised that there was indeed a genuine systemic issue. Even so, the aftermath was disruptive.

Nixon was not by any means the first US president to leverage the central US role in the IMFS. In the 1956 Suez Crisis, President Dwight Eisenhower threatened to block IMF resources for the United Kingdom if it did not comply with a UN General Assembly resolution that demanded a ceasefire and troop withdrawal from the Sinai.[6] However, Eisenhower's action responded to a broadly multilateral initiative backed by most IMF members.

The US hegemonic position in the Bretton Woods IMFS and the dollar's centrality were intimately linked to the global security role it embraced after World War II, once its political establishment perceived the outlines of the Cold War.[7] But there had long been a strong native strain of isolationism that could have taken America in a more inward-looking direction. Senator Robert Taft of Ohio, the favourite of conservative Republicans, appeared to be the likely Republican presidential nominee as the 1952 election year approached. While supportive of the Marshall Plan, Taft had voted against the Bretton Woods Act and the North Atlantic Treaty. He was sceptical of President Truman's involvement in Korea. In an echo of today's US debates over geopolitics, Taft warned that an overly aggressive posture towards the Soviet Union might lead to "World War III". His progress was derailed and the United States set on a different course when Eisenhower, then the Supreme Commander of the North Atlantic Treaty Organization (NATO), declared his candidacy and won the Republican nomination.

To be sure, US administrations were not blind to trade-offs between America's foreign security undertakings and the balance of payments, which in turn was perceived as a constraint on domestic macroeconomic policies. Providing security in Europe and Asia worsened the US trade balance. In a "Special Message to the Congress on Gold and the Balance of Payments Deficit", President John F Kennedy announced within weeks of taking office in 1961, "I have [asked the Secretary of Defense] to review the possibilities for savings in the logistic support of our forces, including the combined use of facilities with our allies. We shall also, where appropriate, urge the purchase of the newer weapons and weapons systems by those of our allies who are financially capable of doing so."[8] He recommended that Congress revise the Federal Reserve Act to allow banks to pay higher interest rates "on time and savings deposits held in this country by foreign governments or monetary authorities …. This authority, when exercised, would enable American banks to make a maximum competitive effort to attract and hold dollar balances which might

6 Boughton (2001).

7 Posen (2008), Eichengreen et al (2019), Weiss (2022) and Rogoff (2025) elaborate on this factor as a foundation of the dollar's global primacy even after the end of Bretton Woods.

8 Kennedy (1961).

otherwise be converted into gold. At the same time domestic rates, when desirable for reasons of domestic policy, could be held at a lower level."

The Vietnam War added further strains – even more so because it was unpopular abroad. In 1966 the United States and the United Kingdom, also under balance of payments pressures, entered trilateral talks on the balance of payments consequences of their troop deployments in Germany. Charles Coombs (1967) of the New York Fed recounted:

– In early May [of 1967], the United States authorities released an exchange of letters growing out of these discussions between the President of the German Federal Bank, Karl Blessing, and the Chairman of the Federal Reserve Board, William McChesney Martin, Jr, in which the former indicated that the Federal Bank intended to continue its practice of not converting dollars into gold as part of a policy of international monetary cooperation. This statement was made with the agreement of the German Federal Government, which at the same time took note of the Federal Bank's intention to purchase $500 million of United States Government medium-term securities in four equal quarterly instalments beginning in July.

Years later, Blessing regretted signing the "Blessing letter", explaining that he feared the threat of American troop withdrawals from Germany. The US desire to pare its spending on global security continued under President Nixon. In his "Guam Doctrine" of 1969, Nixon clarified the limits of American foreign military involvement in aid of its allies, while (not coincidentally) promoting American arms sales abroad.

Even though the original Bretton Woods blueprint had not been friendly to private capital movements, which were initially quite limited, financial integration increased as more countries returned to current account convertibility, as they eased other financial restrictions, as trade expanded and as US multinationals increasingly operated abroad. In the 1960s, the US instituted several capital account measures to discourage outflows and thereby unwittingly helped set the stage for the dollar's even more thorough global dominance post Bretton Woods. The key conduit was the eurodollar market. It originated in the mid-1950s because of several factors, including UK regulatory forbearance, arbitrage of inconsistent bank deposit interest rate caps and Soviet bloc countries' desire to shield dollar reserves from confiscation.[9]

As Mikesell (1975) and McCauley (forthcoming) set out, US attempts to limit capital outflows and tax foreign bond issuances in New York helped move dollar banking and debt placements offshore – while probably failing to improve the overall US balance of payments.[10] US reserve requirements and the Regulation Q limitation on deposit interest also fed offshore banking. Mikesell (1975) estimates the size of the eurocurrency market (mostly dollars) at $105 billion at the end of 1972, more than double its size three years earlier. (At the end of 1972, M2 for the United States was $802 billion.) Moreover, as McCauley observes, central banks supported the eurodollar market through actions to alleviate its funding strains at key points in the 1960s.

9 See Hirsch (1969), Schenk (1998) and McCauley (forthcoming). An intensification of sterling exchange controls after the Suez Crisis may have led to more acceptance of dollar deposits by London banks; see Ibietatorremendía (1992).

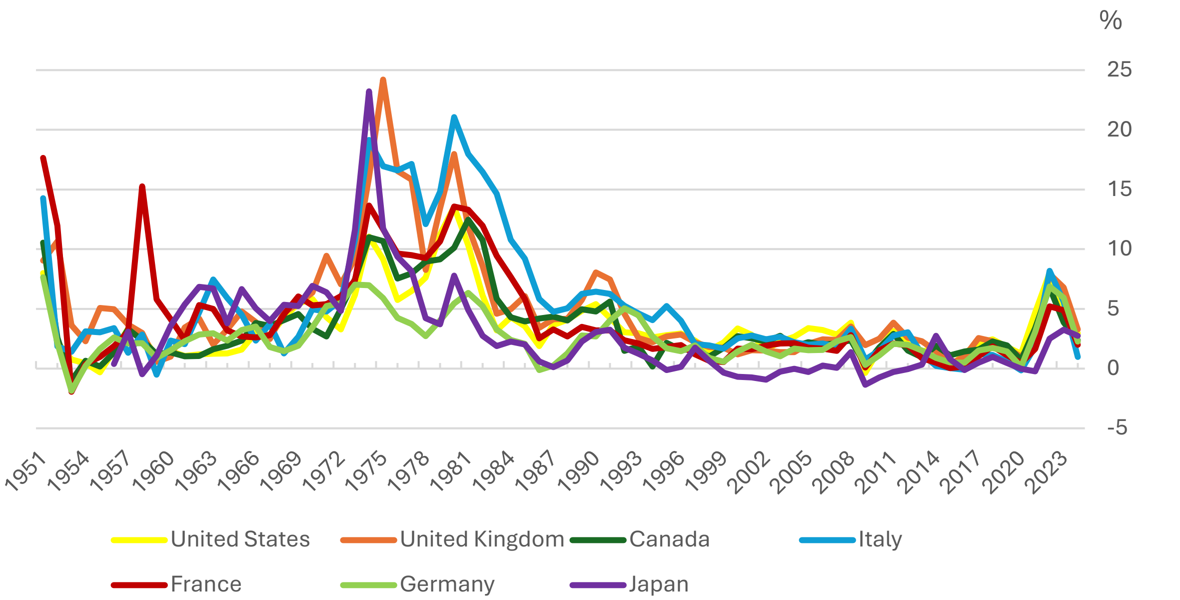
10 Hewson and Sakakibara (1975).

There is little doubt that the growth of the offshore dollar market amplified the greater capital mobility and speculation that helped bring Bretton Woods down. But it also gave the dollar an even bigger head start in the next incarnation of the IMFS.

The 1970s: change amid price instability

The year 1973 brought not only floating exchange rates but also an explosion of global inflation in a world now without a nominal anchor (Graph 3). Country-specific propagation mechanisms and shocks certainly were in play, but several common factors also operated. One was the Organization of the Petroleum Exporting Countries (OPEC) hike in oil prices, not unrelated to the US abandonment of gold. Another was the global impact of speculation against the dollar.

Inflation rates for G7 countries, 1951–2024 Graph 3



Sources: IMF, International Financial Statistics, via Macrobond; Bank of England.

The main channel through which the US external balance problem was transmitted abroad before March 1973 was not through excessive US money supply growth per se and a bigger US current account deficit, but instead via speculative financial inflows into non-dollar currencies. This forced authorities to purchase large quantities of dollars to hold their currencies down in foreign exchange markets. These purchases inflated foreign reserve holdings and, when imperfectly sterilised, money supplies (Solomon (1982), chapter XI). Official holding of some reserves as eurodollars made matters worse. Table 1, adapted from Heller (1976), illustrates the rapid growth of international reserves in the early 1970s.

Global foreign exchange reserves, 1959–74

Table 1

	1950–59	1960–69	1970	1971	1972	1973	1974
End-of-period reserves (billions of US dollars)	57.7	78.1	92.4	130.3	158.1	181.8	218.0
Growth rate of reserves (per cent)	2.3	3.1	18.1	41.0	21.3	15.0	19.9

Reserve growth rates shown for the decades of the 1950s and 1960s are averages of annual growth rates.

Source: Heller (1976), based on data from IMF, International Financial Statistics.

The environment in 1973 was not favourable for the dollar to stay dominant. Some predicted a return to conditions more like those of the 1930s, with a multipolar system centred on sterling, the French franc and the dollar.[11] Moreover, with central banks no longer obliged to intervene in defence of dollar exchange rates, the rationale for holding dollar foreign exchange reserves seemed much weaker. Kindleberger himself, long a booster of the dollar's pivotal global role, declared it to be "finished" as the world's currency.[12]

The Interim Committee of the IMF Board of Governors agreed in 1976 to amendments to the Fund's Articles that would legalise floating exchange rates. These changes and others were incorporated in the second amendment to the Articles in 1978. Tellingly, the new Articles mentioned the US dollar only twice, and then only vestigially, as opposed to the 18 mentions in the Articles of 1944. This change was in line with the position of the United States, which believed that the original agreement had "denied it the choice of policies in relation to the exchange rate for its currency that had been available to other members with respect to their currencies".[13]

The first amendment to the Fund's Articles (in 1969) had created the Special Drawing Right (SDR), a synthetic reserve asset issued by the IMF, linked to a currency basket and meant to supplement dollar reserves in the hope of mitigating the Triffin dilemma. The amended Articles of 1978 called for promoting the SDR as the "principal reserve asset in the international monetary system". To that end, the IMF's management proposed a "substitution account" whereby the Fund would take on members' foreign reserves and issue SDRs in exchange. Given the dollar's ongoing weakness in the late 1970s (Graph 4), this could have been a welcome diversification opportunity, but someone would have needed to indemnify the Fund if it went long on dollars and the dollar continued to fall. The United States had no intention of guaranteeing the value of its foreign official dollar liabilities, as it had before August 1971, and the substitution scheme failed.

However, other factors were raising the dollar's international standing. One was the extensive offshore eurodollar market, inflated by official reserve acquisitions in the early 1970s. When the US Treasury terminated capital controls in January 1974, the onshore and offshore dollar markets

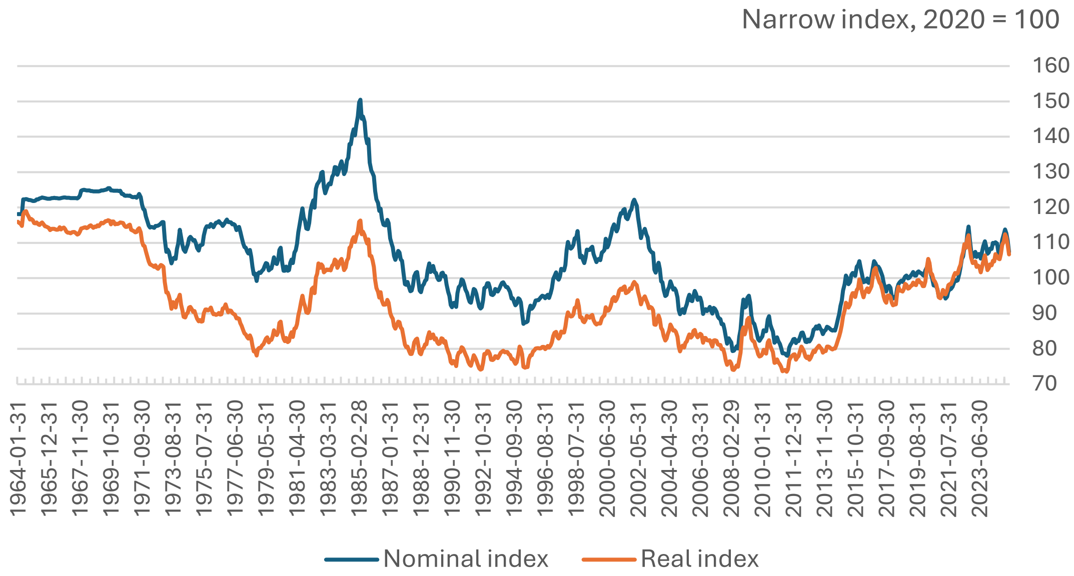
[11] Eichengreen and Flandreau (2009), Harris (2021) and Vicquéry (2022).

[12] Le Maux (2025).

[13] Gold (1978, p 13).

effectively merged into a unified cross-border market for dollars. Later that year, US backstopping of offshore deposits at the failing Franklin National Bank demonstrated the Federal Reserve's willingness to play a lender of last resort role in the eurodollar market, as did US pressure on other central banks to promise support for eurocurrency markets (McCauley (forthcoming)). Further financial deregulation would solidify the central global position of US banks and financial markets. Innovations in the plumbing of payments mattered as well. The year 1970 saw the founding of the Clearing House Interbank Payments System (CHIPS), which would place US banks at the centre of the global dollar payments network.

Nominal and real effective exchange rate indices for the US dollar, 1964–2025 Graph 4



Source: BIS

Growing integration of global financial markets coupled with floating exchange rates brought financial stability issues to the fore, specifically the dangers of supervisory gaps owing to cross-border banking activity. And as Crockett (2010) perceptively observed, the greater reliance on market forces to organise economic activity shifted the emphasis of policy from discretionary interventions to better design of the rules of the game:

– The growth of financial markets signaled significant changes in the basic model within which international economic relations were managed. The relative importance of *governmental* decisions about exchange rates, liquidity creation, and so on declined relative to *regulatory* decisions about how financial institutions and markets were supervised.

The financial stability challenge, crystallised by the Bankhaus Herstatt and Franklin National crises in 1974, led (among other developments) to more intensive regular engagement of central bankers through the Bank for International Settlements (BIS) and regulatory coordination through the Basel Committee on Banking Supervision (BCBS). These innovations were the seeds for an evolving structure of international supervisory cooperation.

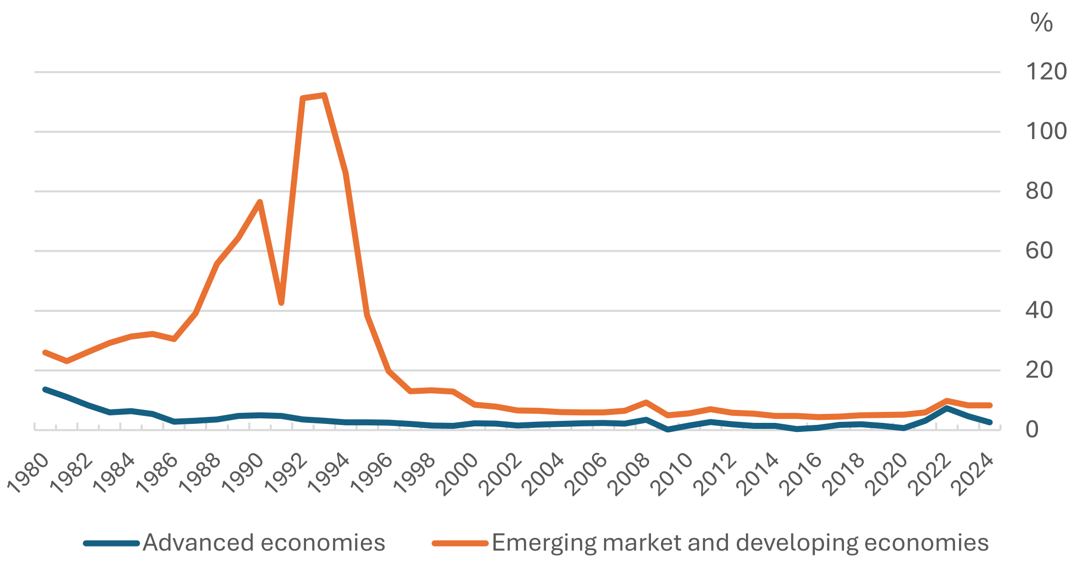
Price stability and globalisation

At the end of the 1970s price stability, not financial stability, was the more salient problem for policymakers (although financial stability threats were building and would emerge soon enough). A major breakthrough in solidifying the dollar's international position was then Chair of the Federal Reserve Paul Volcker's decision late in 1979 to do "whatever it took" to restore price stability in the United States.

Volcker demonstrated that a central bank willing to tolerate a deep recession, and with the political capacity to do so, could reduce inflation substantially. Margaret Thatcher's government in the United Kingdom underscored that message, and the ensuing global recession contributed to lower inflation in other industrial economies (Graph 3).

These lessons contributed to the emergence of inflation targeting around the end of the 1980s and the spread of central bank independence in the target's pursuit. It seems fair to say that inflation targeting, which in some form eventually became accepted best practice in many emerging economies as well as in the industrial world, evolved into the de facto nominal anchor for the floating rate IMFS. In emerging economies, the move towards inflation targeting, starting in the late 1990s, coincided with growing exchange rate flexibility and more economic openness. Early adopters included Korea (1998), Brazil (1999), Colombia (1999), South Africa (2000), Malaysia (2000), Thailand (2000), and Mexico (2001). Graph 5 illustrates how inflation has declined worldwide under this monetary regime, accompanied by other reforms.

Annual inflation in advanced and emerging market and developing economies — Graph 5



Source: IMF, World Economic Outlook database, April 2025.

With Volcker's disinflation and the fiscal expansion of the Reagan administration, the dollar's weakness in the late 1970s gave way to a rapid climb unmatched since (Graph 4). The epic appreciation sharply reduced previous desires to diversify out of dollar foreign exchange reserves. Perhaps paradoxically, the rapid government debt issuance of the Reagan era was probably a stimulant to the dollar's primacy, as it provided a substantial stock of safe internationally traded assets. The resulting "thick market" effects reinforced the dollar's centrality.[14] And Reagan ultimately recognised the need for revenue-enhancing measures to ensure long-run government solvency, such as those in the 1983 social security reform.

The logic of the monetary trilemma suggests that countries freed from the need to peg exchange rates would be able to liberalise their capital accounts without abandoning policy independence. However, this freedom does not imply that they were obliged to do so. Nonetheless, the industrial economies did, followed later by many emerging markets.[15] The rapid growth of global financial trade reinforced the dollar's international standing.

The United States was a pioneer in deregulating international capital flows and finance, hosted deep and liquid capital markets, followed a market-led economic model and offered robust legal protections for creditors under a strong rule of law.[16] The Carter and Reagan administrations pursued financial deregulation further and cemented the United States' preeminent status in global finance. Financial liberalisation in the United States has had a competitive effect globally, as financial and industrial elites outside the US have pressured their own governments to liberalise in pursuit of global market share.

Having promoted the eurodollar market to maintain its traditional position in banking and securities trade, the United Kingdom in 1979 eliminated capital controls dating back to the 1940s and in 1986 deregulated the London Stock Exchange in a "Big Bang". Financial liberalisation on the European continent during the 1980s, and specifically the dismantling of capital controls by the end of that decade, was motivated not only by a desire for closer economic union but also by local pressures to be more competitive with Anglo-American finance. Japan started opening its capital markets in 1984 under pressure from the US Reagan administration, which believed that the move would strengthen the yen and reduce Japan's big bilateral trade surplus with America. The initiative occurred against a backdrop of tensions over Japan's trade policies and defence spending. But Japan subsequently embraced the project of internationalising the yen.

The result was an explosion of international financial transactions, given an assist by the end of the Cold War and the spectacular growth of world trade in the hyper-globalisation era that followed.[17] Finance and trade complemented each other in supporting the dollar's international role, as suggested by the theoretical work of Gopinath and Stein (2021).

The expansion of global finance required a more cooperative multilateral structure to ensure financial stability. Already in the early 1970s with initiatives centred on the BIS, including the BCBS, the IMFS had started evolving along all three dimensions identified by Crockett (2010).

[14] Rey (2001), Copolla et al (2024).

[15] Obstfeld (2021).

[16] La Porta et al (1998) and Rogoff (2025).

[17] Subramanian and Kessler (2014).

Management of the developing country debt crisis in the 1980s likewise had a multilateral aspect, though the process was lengthy and cost debtors dearly. Later, in 1999, came the Financial Stability Forum, first chaired by Crockett himself and renamed the Financial Stability Board (FSB) in 2009 with expanded national representation. In response to a major change in the model of international financial relations, new institutional arrangements arose, and the distribution of decision-making power evolved simultaneously to reflect new geoeconomic realities. Once largely a club for rich countries, the BCBS consulted a range of emerging markets in developing its 1997 Core Principles of Banking Supervision. Emerging market economies now play an essential role in international regulatory cooperation.

The post-1973 IMFS has fulfilled key functions of the Bretton Woods system in different ways, but with important areas of continuity:

- The dollar has remained the preeminent currency for reserves, invoicing, funding and foreign exchange (FX) swaps. It is the leading anchor and vehicle currency. The most recent BIS triennial survey showed it as being on one side of 88% of FX transactions.[18]
- As noted, nominal anchoring is a national responsibility that most advanced and emerging economies have embraced, together with some form of central bank independence. The problematic US gold price commitment of Bretton Woods is long gone.
- Whereas before 1973, lending between central banks was intended to support currency intervention, current swap lines, revived in 2007, support financial stability and are an important complement to the dollar's funding currency role.
- The IMF continues to provide international liquidity, but private financial markets play the key role, supplemented by swap lines, Fed lending to foreign branch offices and gross reserve accumulation for self-insurance. The Fed's Foreign and International Monetary Authorities (FIMA) facility enhances the liquidity of dollar FX reserves in crises.[19]
- Rapid FX reserve accumulation by emerging markets in the 15 years following the Asian financial crisis in the late 1990s led to concerns of a new "Triffin dilemma" – that the global supply of "safe" reserve assets might fail to keep pace with the official demand. However, the global demand for dollar reserves has been flat in nominal terms for about a decade, and total Treasury issuance has increasingly outpaced rises in foreign holdings.[20] With sounder macro policy frameworks, emerging market economies seem better able to manage on the basis of private financial flows.
- Central bank cooperation in general focuses more on financial stability than on exchange rates, although there have been important cases (such as the 1985 Plaza Accord) where central banks have intervened to weaken the dollar and other cases (the Louvre Accord

[18] Bertaut et al (2023), Ilzetzki et al (2019), Borio et al (2022) and BIS (2022). A forthcoming survey is IMF (2025).

[19] Goldberg (2024).

[20] On the "new Triffin dilemma", see Farhi et al (2011), Obstfeld (2014) and Farhi and Maggiori (2018). On the level of global dollar reserves, see Obstfeld (2025).

of 1987 or the adoption of the Rubin 1995 "strong dollar" policy) where central banks have cooperated to put a floor under the dollar.

- Floating exchange rates have imparted greater symmetry to countries' scope for monetary autonomy, but US monetary policy still plays an outsized role globally because of America's size, its financial market footprint and the dollar's unique role as international currency (Rey 2017, Avdjiev et al 2019, Obstfeld and Zhou 2022).
- The United States now has the freedom to alter the dollar's exchange rate, but some US policymakers have still voiced concerns that currency manipulation by trade partners or the dollar's global status have impeded its depreciation to a level consistent with an equilibrium current account balance.
- The United States has continued until now to underwrite security around the world, despite the growing military strength of competitors such as China and, in recent years, Russia. No country has replaced America as the global hegemon, but US hegemony has increasingly been contested and, as of 2025, the United States is choosing to retreat pre-emptively from key global leadership roles.

As it evolved, the IMFS that prevailed for five decades between 1974 and 2024 supported an unprecedented expansion of global trade and finance and the spread of price stability around the world. It promoted continuing global growth and considerable convergence between poorer and richer countries. Human development indicators rose worldwide. The dollar's role as a "global currency" could be a key reason why floating exchange rates failed to fragment international trade in the way some critics of floating rates predicted in the early 1970s. Crises, some quite serious, increased in frequency after the Bretton Woods years, but cooperative institutions developed to reduce their likelihood and severity. While far from perfect, the system showed considerable resilience in the face of the Covid-19 pandemic and the global response to post-pandemic inflation.

The new US administration is not talking about improvements in the existing IMFS, but rather about a fundamental reorientation away from the principles of multilateralism that have largely underpinned the system (and its broad success) since 1945. We are indeed at a fork in the road. Many questions about the future shape of the IMFS are interrelated, but they converge in considering the international role of the dollar.

Prospective financial fragmentation and the dollar

Under the executive and like-minded Congress in power since January 2025, the United States is now undermining key advantages that have underpinned the dollar's postwar global role. At a spring 2023 conference at the Peterson Institute for International Economics devoted to assessing a half century of floating exchange rates, most participants agreed that the dollar's dominating position, while not unassailable, remained fundamentally secure. Only two years later, the ground has shifted.[21]

The dollar's primacy is based not only on strong fundamentals (relative to other currencies) but also on powerful network externalities, which amplify the force of fundamentals through self-fulfilling mechanisms. The externalities buttress the dollar's position but could go into reverse to accelerate a decline. A deterioration of dollar fundamentals beyond a certain point will induce foreign governments to invest in enhancing competitor currencies' relative fundamental positions. Once network effects take over, the dollar's global dominance could be materially impaired. While no other currency is currently positioned to supplant the dollar, the existing dollar-dominated equilibrium – despite the economic advantages it confers – might be destabilised and give way to a more fragmented, multipolar system.

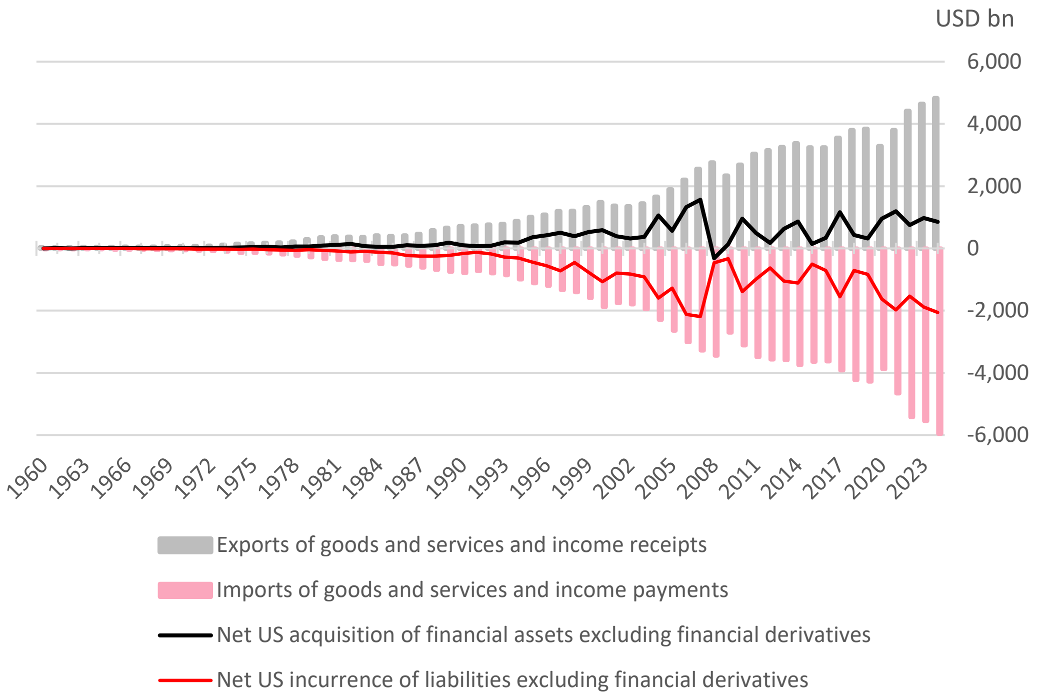
The Trump administration is seeking to revise long-standing assumptions about both US international relations and domestic political institutions. Concerning international relations, the United States has taken a coercive posture that threatens to withhold market access while scaling back US support for key global public goods. Concerning domestic institutions, the administration seeks a more muscular executive, freed of previously accepted constraints on realising the supposed "will of the people" – for example, judicial judgments, independent agencies and a non-partisan civil service. These initiatives are intimately connected because domestic political constraints on the executive can limit freedom of action regarding international policies, while international undertakings can constrain some domestic actions. Together, however, the parallel Trumpian offensives on the international and domestic fronts threaten all of the main foundations on which dollar dominance has relied. The result will be an international retreat from the dollar and greater international economic fragmentation, including in financial markets.

The openness of US markets to foreign trade and investment has been a major factor behind the dollar's postwar ascendancy. The scale of trade transactions should not be underestimated. The volumes of gross current account credits and debits remain large, even larger than US residents' net purchases of foreign assets and net sales to foreigners of domestic assets to foreigners (Graph 6). US trade leaves a large footprint in the foreign exchange market. Thus, US policies like across-the-board tariffs or clumsy export controls that sharply reduce foreign trade, not just integration with global financial markets, would impair the dollar's international role.

[21] See the chapters in Irwin and Obstfeld (2024).

Gross US current account credits and debits versus net financial outflows and inflows

Graph 6



Source: US Department of Commerce, Bureau of Economic Analysis.

Current US policies towards trade, as well as the US government's broader retreat from multilateral engagements, are predicated on three main grievance areas: unfair global trade, unfair global capital markets and an unfair burden of expensive foreign security commitments (broadly defined). US complaints in all these areas are not new, as I have noted, and the complaints are not entirely without merit either. What is new are the magnitude and breadth of the damages claimed, the zero-sum mindset behind the claims and the attempt to achieve redress by recasting global arrangements that have evolved over years and that have broadly served US interests.

Specifically, Trump's economic team holds that the US has heretofore provided three main global public goods with insufficient compensation or reciprocity from the rest of the world. First, open US markets for goods imports are alleged to have caused trade deficits that drain America of manufacturing jobs and wealth. In more sophisticated versions of this critique, the United States is forced to prop up artificially low global demand through self-harming external deficits. Second, providing the world with a global currency – the dollar – comes at the cost of an overvalued currency and chronic trade deficits. More broadly, the charge that the United States suffers from deficient demand abroad relies on foreign saving flows entering open and efficient US capital markets without impediment, thereby bidding up the dollar. Third, US commitments to global military security (for example, through NATO) or to food and health security (for example, through the US Agency for International Development and the World Health Organization) are excessively burdensome compared with the benefits derived.

These critiques ignore some obvious contrary facts. Overall, the United States is not the victim of widespread trade discrimination. However, the persistent US federal deficit, equal to 6.4% of GDP in 2024, plays a major role in driving US external trade deficits. The dollar's global status may make the dollar stronger, but it also allows US entities – including but not restricted to the government – to borrow from abroad at lower interest rates. US undertakings for global security also make America itself safer in several dimensions.

The global status of the dollar has flowed not just from the United States' economic weight but also from a more capacious reading of the country's international role and the country's openness to world markets. With little exaggeration, what Mundell (1968, p 288) said about gold in an earlier era could be paraphrased to apply to the dollar's role up until now: "[The dollar] has been the anonymous monarch in a world of creative nationalism, and it has counted for more than a mere medium of exchange and contract; it has symbolised internationalism and the rule of international law."

The current direction of US policy poses several specific threats to the dollar's centrality and to the integrity of international markets:

- Actual or threatened tariffs and export bans are sure to shrink the volumes of US imports and exports, diminishing US integration with the global economy and restricting the dollar's international role. Reactive measures by trade partners, either in retaliation or simply to insulate themselves from US policy volatility by diverting trade away from the United States, will reinforce these effects.
- Pressure on Federal Reserve monetary policies, which undermine the Fed's credibility and raise the threat of higher and more volatile US inflation, strike at a key pillar of the dollar's global role. A more subtle challenge to the Fed's monetary control would come from a purposeful shortening of debt maturities by the Treasury, aimed at lowering long-term yields (while ignoring higher risks of a funding crisis).
- US federal debt in the hands of the public now stands at around 100% of GDP; under the version of the One Big Beautiful Bill Act (OBBBA) proposed by the House of Representatives, the debt would expand to around 125% of GDP by 2034, and to even higher levels if interest rates rise or if temporary provisions in the Act are extended. Fiscal incontinence in a world of permanently higher real interest rates opens the US Treasury to funding crises and opens the Fed to more intense pressure to monetise deficits.[22] Funding crises are more probable, considering diminished foreign participation in the US Treasury market (now below 35%, having been 50% in 2009) and potential liquidity stresses.[23] Were the Federal Reserve pressured to intervene with large-scale asset purchases in a funding crisis, the risks of a slide into fiscal dominance would rise.

[22] Pflueger and Yared (2024), Afrouzi et al (2024). Unanticipated inflation is one form of default, but in addition, credit default swap prices for Treasuries have been elevated since early 2023 and jumped up in early April 2025.

[23] See Duffie (2025) on the structure of the Treasury market.

President Trump has already complained of Fed Chair Jerome Powell, "He is costing our Country a fortune."[24]

- One reason for low dollar borrowing costs is the "safety premium" on US Treasuries. The premium has depended, inter alia, on past tendencies for the dollar to appreciate and for Treasury yields to fall as equity markets fall during global crises – even crises affecting the United States.[25] These correlations may switch durably if US monetary, fiscal and other policies become unrestrained.[26] After the US tariff announcements on 2 April 2025, the dollar fell, long-term Treasury yields rose sharply, and equities fell, unlike the normal pattern. To date, the US currency has not recovered (Graph 7). A negative correlation between the dollar and Treasury yields makes Treasuries riskier, raising mean Treasury yields. Fiscal space is compressed as a result.

- The long-term willingness of the United States to abide by the "soft law" agreements of the BCBS and the FSB is questionable (as is the readiness of global regulators to accede to US demands to keep America on board). Cooperation in the crypto sphere will prove especially challenging.[27] The result will be international segmentation of financial markets if agreement cannot be reached – or greater financial instability if the United States insists on lowering the bar and others agree. In an 18 February 2025 order, President Trump demanded to preapprove "all proposed and final significant regulatory actions" by "all executive departments and agencies, including so-called independent agencies". The document clarified, "This order shall not apply to the Board of Governors of the Federal Reserve System or to the Federal Open Market Committee in its conduct of monetary policy. This order shall apply to the Board of Governors of the Federal Reserve System only in connection with its conduct and authorities directly related to its supervision and regulation of financial institutions."[28] It is not clear where in this dichotomy the Fed's participation in proposed cross-border payments consortia would fall. There could also be contestable areas related to the Fed's lender of last resort and market-making functions, including international swap lines.[29]

24 M McCormick, "Donald Trump calls for 'full point' rate cut after jobs report," *Financial Times*, 6 June 2025.

25 Duffie (2023), Acharya and Laarits (2025).

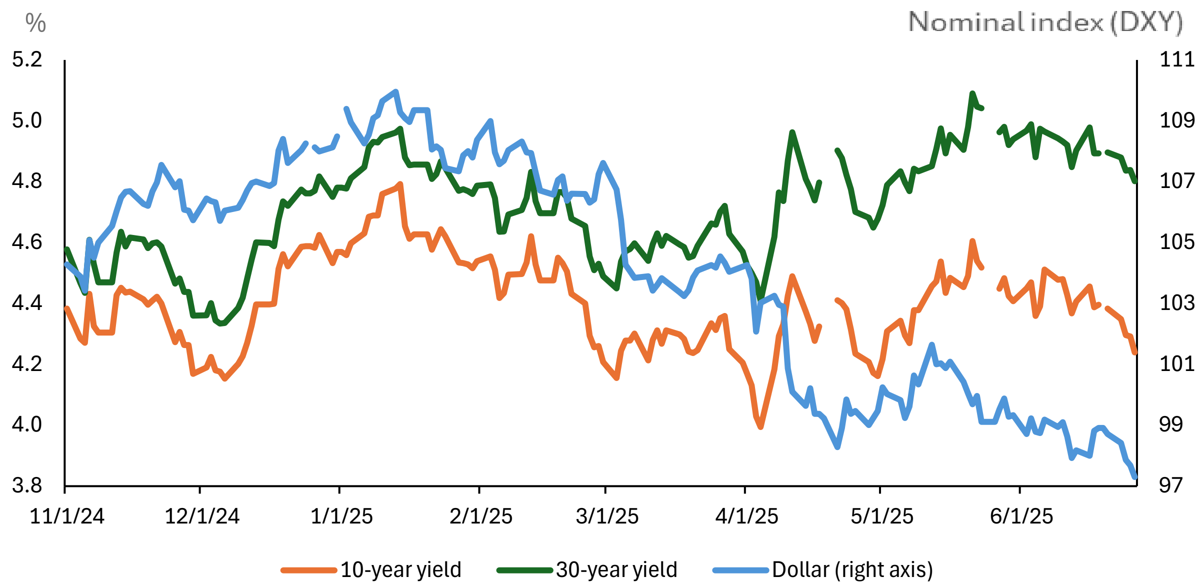
26 In this event, the United States becomes susceptible to the emerging markets "original sin redux" syndrome of Carstens and Shin (2019), which raises capital account volatility.

27 Chari et al (2025).

28 White House (2025). The 22 May 2025 Supreme Court decision in *Wilcox v Trump* affirmed the president's right to fire heads and board members of independent agencies, but with a contorted exception for the Fed. Eichengreen (2025) assesses the decision and rightly worries about the future implications for monetary policy independence.

29 The Fed's preferred direction may become clearer after a planned July conference on "potential changes to leverage ratio requirements and stress testing", along with "discussion of potential reforms to the GSIB surcharge and the Basel III capital requirements" (Bowman 2025). But the executive will have to consent.

Long-term nominal Treasury yields and the US dollar nominal exchange rate	Graph 7



Sources: Bloomberg and MarketWatch.

- Central bank dollar swap lines have been a critical complement for dollar funding by banks that lack access to the Fed discount window. Their possible absence or conditionality is already prompting euro area regulators to push banks towards less reliance on the dollar. More generally, fears that the United States will more regularly weaponise its grip on dollar-based global payments can only have risen in the past six months, giving further impetus to attempts to decouple from the dollar.

- Some US economic leaders wish to promote dollar stablecoins as key elements in further solidifying the dollar's influence worldwide.[30] The so-called GENIUS Act just passed by the US Senate will seek to regulate stablecoins within a framework that allows their integration into the existing ecosystem of bank and non-bank intermediaries. The initiative is concerning for several reasons, but it raises specific questions about international economic relations. Will countries outside the United States permit digital dollarisation, possibly diminishing monetary sovereignty in some cases? Will they react by developing alternative distributed ledger conduits for their own currencies, a tack that might be easier for Europe after additional payments infrastructure investments, expansion of the universe of safe euro bonds and other necessary reforms?[31] Will they erect barriers to dollar stablecoin use? Will the US cooperate to limit contagious financial instability due to questionably backed stablecoins? How will countries collaborate to restrict the use of stablecoins for illicit transactions – and will the United States be a good-faith partner? Will the financial interests promoting stablecoins for cross-border

[30] See Chari et al (2025).

[31] Lagarde (2025).

transactions effectively block Fed participation in a central-bank-based cross-border system? (President Trump has already forbidden a Fed central bank digital currency through executive order.) More geopolitical fragmentation of payment systems seems likely.[32] Aside from the strong personal stakes some key Trump administration players have in the crypto industry, global proliferation of dollar-based stablecoins could raise the demand for Treasuries, lowering their yields – a benefit in the eyes of US fiscal policymakers.

- Influential voices outside the Trump administration, such as Michael Pettis (2024), have advocated capital inflow taxes to reduce the US trade deficit and weaken the dollar. While such policies have been advocated by some US senators, they have not been floated by the Trump White House. Not yet. But as tariff policy fails to reduce trade deficits in the face of burgeoning fiscal deficits, such taxes could appear more attractive, while also serving a populist narrative of blocking foreign acquisition of US wealth. They have substantial revenue potential as well. (Never mind the administration's concurrent goal of generating large-scale inward foreign direct investment.) One precursor could have been section 899 in the OBBBA, the so-called "revenge tax", which would have allowed higher withholding taxes on investments from countries "unfairly" taxing US firms (eg via the Pillar Two undertaxed profits rule or digital taxes). As of this writing, the Congress looks likely to drop the idea in consideration of assurances from other Group of Seven countries, though passage of such a far-reaching interventionist measure by the House sets an ominous precedent. The OBBBA provision for taxing migrants' remittances abroad puts in place a mindset that could be more widely unleashed on outflows. Greater discretion over international income flows delivers tools that can be used coercively, heightening uncertainty and fragmenting markets.

- A US retreat from its role as a promoter of global security – perhaps to a sphere of influence that leaves the rest of the world to China and other powers – will inevitably shrink the dollar's realm, while also promoting deglobalisation. The US security umbrella encouraged not just dollar use but also economic openness worldwide. The fleeting sense of security that followed the fall of the Soviet empire allowed governments to feel safer sacrificing national social cohesion in favour of economic efficiency via globalisation. For all the advantages of the latter, we are now paying the price of the former. The balance is shifting, no more strongly than in the United States, and a less universal role for the dollar is a likely consequence.

The preceding list does not exhaust the current headwinds to continued worldwide confidence in the dollar. Also at play are the US administration's incursions on key domestic institutions – the courts, the legislative branch, state governments, the press, the civil service, due process, the legal profession, government data integrity, universities, the medical science establishment and norms surrounding self-dealing by public officials. Foreign observers contemplating their economic relationships with the United States read these developments as signals of institutional decay and watch them with dismay.

[32] For further discussion, see James et al (2019) and Ferrari Minesso et al (2025).

Stability of a country's currency and debts is central to internal social stability; when that country is a great power with global reach, the stability of the IMFS itself is at stake. Treasury Secretary Alexander Hamilton understood this when he assumed the US states' debts and explained the need for market confidence in federal debt management. As he wrote in his *Report Relative to a Provision for the Support of Public Credit* (January 1790):

– States, like individuals, who observe their engagements, are respected and trusted: while the reverse is the fate of those, who pursue an opposite conduct.[33]

Over much of its history, this advice has been a north star for the US government, pursued if not always attained in practice. Perhaps those days are over. Recent US political developments have momentous implications for the future of the IMFS, which until now has been anchored by treaties, rules, institutions and norms. Another observation of Andrew Crockett's, although made in a different context, applies here: "In a sense, anchors are no better than the ground in which they are planted. And that ground could, at worst, turn out to be quicksand."[34]

Fewer than six months into the second Trump presidency, there is still time for the United States to take a different road. That would require a more constructive approach to its global relationships and a reversal of pressures on the many institutions that have long underpinned US economic and political stability. In a much more dangerous, fragile and interconnected world, a US failure to pivot from its current course will inevitably trigger international responses and could have even more dire consequences than a century ago.

33 Cited in Sylla and Cowen (2018, p 80). Hamilton memorably justified federal assumption of the states' debts with this phrase: "It was the price of liberty."

34 Crockett (2000).

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