

## The Dollar's Special Status: Sources and Threats

*di Paul Krugman*

A recent news analysis by [Al-Jazeera](#) stated:

As the United States-Israel war on Iran — paused for two weeks on Wednesday amid fresh diplomatic talks — has roiled the global economy for more than a month, Iran and China have seized the opportunity to address a shared gripe about the global financial system.

Their common cause: ending the hegemony of the US dollar.

The motivation for this article was the fact that Iran is levying tolls on ships passing through the Strait of Hormuz, to be paid in yuan or cryptocurrency – not dollars.

There's no question that many countries – China, in particular – want to see the dollar dethroned. And even before the omni-shambles of the Trump II administration, there were waves of what Paul Blustein, the author of [King Dollar](#), calls “dollar doomerism” – claims that the demise of the dollar's role as the dominant international currency is imminent.

Thus, conservatives used to declare that budget deficits and monetary expansion would end the dollar's dominant status. Today, critics of the Trump administration argue that demise of the dollar will be one of the dire consequences of America's fecklessness and abuse of power. Whichever side of the political spectrum these claims come from, they are accompanied by declarations that America will suffer from the dollar's losing its position as the dominant world currency.

But is the dollar at imminent risk of losing its special status? If it does lose that status, will that be a major blow to the United States?

I believe that the answer to both questions is no. Given its behavior, the United States may in some sense deserve to lose its status as owner of the world's dominant currency. But economics is not a morality play. It would take a lot more than a change in the

currency denomination of some payments for oil to dislodge the dollar from its leading position. And in any case, the dollar's privileged position in global markets matters much less than many people imagine.

Today's primer will be devoted to theory and evidence on the international role of the dollar. Beyond the paywall, I'll address the following:

1. What do we mean by "international currencies"?
2. What is the dollar's international role?
3. What explains the dollar's special status?
4. How much does this special status matter for US power and prosperity?
5. What would it take to dethrone the dollar?

### *International currencies: An introduction*

During World War II, Western prisoners of war weren't completely cut off from the outside world. In fact, they regularly received packages containing food, clothing, and cigarettes (it was the 1940s) from the Red Cross. And in established POW camps these packages formed the basis for [miniature economies](#) in which prisoners swapped items or exchanged items for services like laundry and clothing repair.

While there was some direct barter — I'll give you something you want in return for something I want — much of the trade was indirect: I'll give you what you want in return for something I may not want myself but can trade for something else. For the most part, these indirect trades involved cigarettes, which were widely accepted even by non-smokers because they were easy to trade for other things.

Wait: This is supposed to be an essay about the global role of the dollar in 2026, so why am I talking about POWs and cigarettes in the 1940s? The answer is that the POW-camp economy is a classic illustration of the natural evolution of money — for that was the role cigarettes played — even without any government to declare what is and is not legal tender.

And the role of the dollar in the international economy is, for all its complexity and sophistication, at a fundamental level similar to the role of cigarettes in those POW camps. There is no world government ordering everyone to use dollars, but almost everybody does. As was the case with cigarettes, people use dollars partly because the

dollar has some necessary attributes for the role, but largely because everyone else uses dollars.

Economists usually say that money fills three essential roles. It is a medium of exchange: A POW wanting to trade tinned beef for help mending his uniform, didn't look for a meat-loving tailor, he traded beef for cigarettes, then cigarettes for sewing. Money is a store of value: cigarettes were usable as money because they weren't perishable, lasting long enough to be used in multiple transactions. And money is a unit of account: Prices in the camps, which were sometimes posted on bulletin boards, were quoted in cigarettes.

The dollar plays all these roles in the world economy — not, for the most part, within nations, but in transactions that cross borders.

An additional twist comes from the roles that governments and quasi-government organizations like central banks play in the international financial system. Thus it's useful to distinguish between the dollar's private and official roles. It's common to describe the role of an international currency with a matrix that highlights three uses in both private and official capacities:

## Roles of an international currency

	Private	Official
Medium of exchange	Vehicle	Intervention
Store of value	Banking	Reserve
Unit of account	Invoice	Peg

Created with Datawrapper

Let me now describe these roles and the extent to which the dollar fills them.

*The dollar as an international currency*

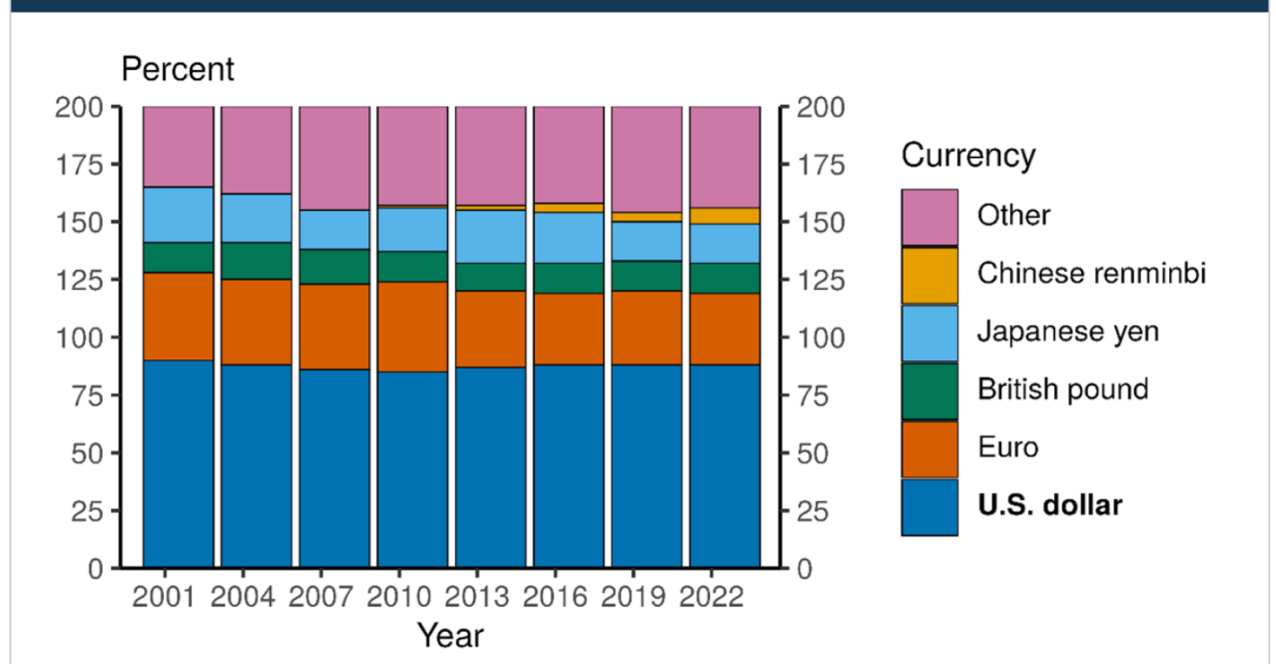
The relationship of the dollar to other currencies is equivalent to the relationship of money to other goods and assets. It's an international medium of exchange: people and institutions that want to swap assets in one country for assets in another often do so through the dollar. It's a store of value: many people and institutions outside the U.S. hold dollars or dollar-denominated claims, particularly when their domestic currency is under threat. It's a unit of account: many prices outside the U.S. are quoted in dollars, and many contracts call for payment in dollars (such as in the global oil market).

In what follows I'll draw almost entirely on an [extremely useful summary](#) by Carol Bertaut, Bastian von Beschwitz, and Stephanie Curcuru, published by the Federal Reserve.

*Medium of exchange:* Brazil mostly trades with China, the European Union, and the United States, as well as with other Latin American nations. Brazil does, however, do billions of dollars' worth of trade with India each year. Presumably, then, businesses need to exchange Brazilian currency — reais (the plural of *real*) — for rupees and vice versa. But a bank that wants to trade reais for rupees doesn't go searching for a bank that wants to do the reverse. Instead, it sells reais for dollars, then uses the dollars to buy rupees.

When a currency plays this role, acting as a medium of exchange between two other currencies, we say that it is serving as a *vehicle currency*. The dollar is the world's overwhelmingly dominant vehicle currency. Here's the share of dollars in all foreign exchange transactions:

Figure 11. Share of over-the-counter foreign exchange transactions



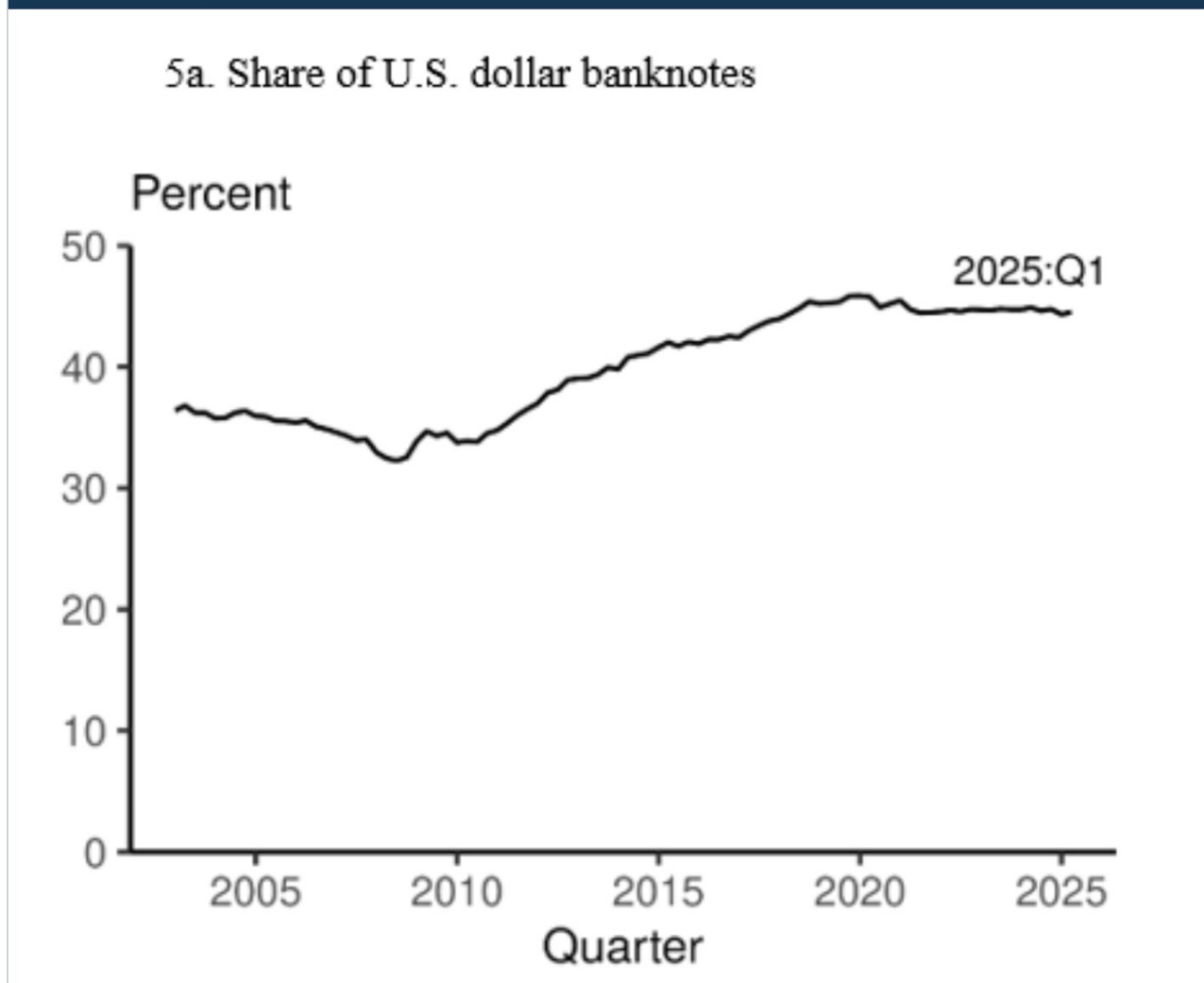
Source: Federal Reserve

These shares sum to 200 percent, because by definition there are always two currencies involved in any foreign exchange transaction. So the dollar share of 88 percent means that the dollar is involved in 88 percent of these transactions, which far exceeds the U.S. share of world trade. This is telling us that dollars are used for many transactions that don't directly involve the United States.

Governments that want to support, or in some cases, weaken the value of their currencies do so by intervening in the foreign exchange markets. But because foreign exchange markets overwhelmingly use the dollar as their vehicle currency, the dollar is also the dominant *intervention* currency.

*Store of value:* We live in a world of debit cards, Apple Pay, Venmo and more; I can go weeks without using physical cash. Yet \$2.4 trillion worth of green pieces of paper bearing portraits of dead statesmen remains in circulation. Who's holding that stuff? To a large extent, foreigners:

Figure 5. Foreign holdings of U.S. dollar banknotes

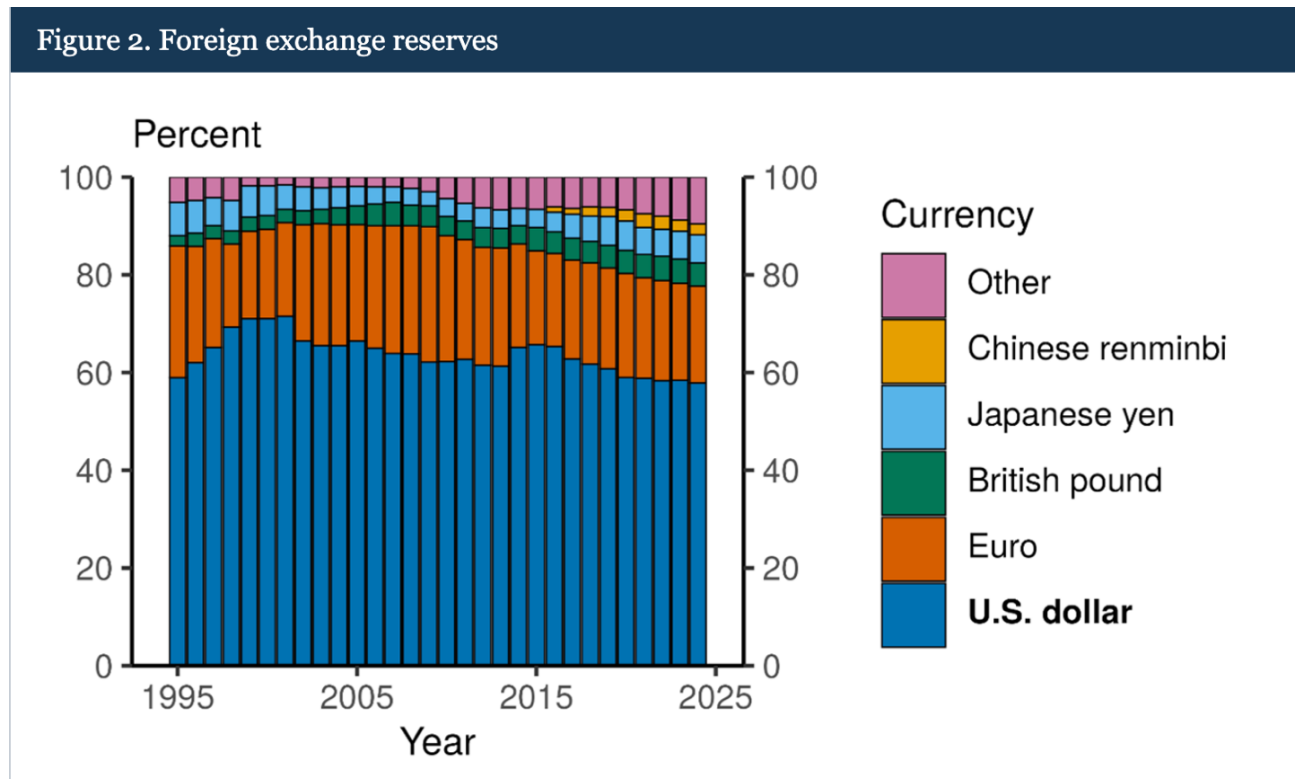


Source: Federal Reserve

But foreign stashes of actual dollar cash, which overwhelmingly consist of \$100 bills and are probably mostly held for at best dubious purposes, are dwarfed by holdings of other dollar assets such as bank deposits, dollar-denominated loans, bonds and more — around [\\$20 trillion in total](#).

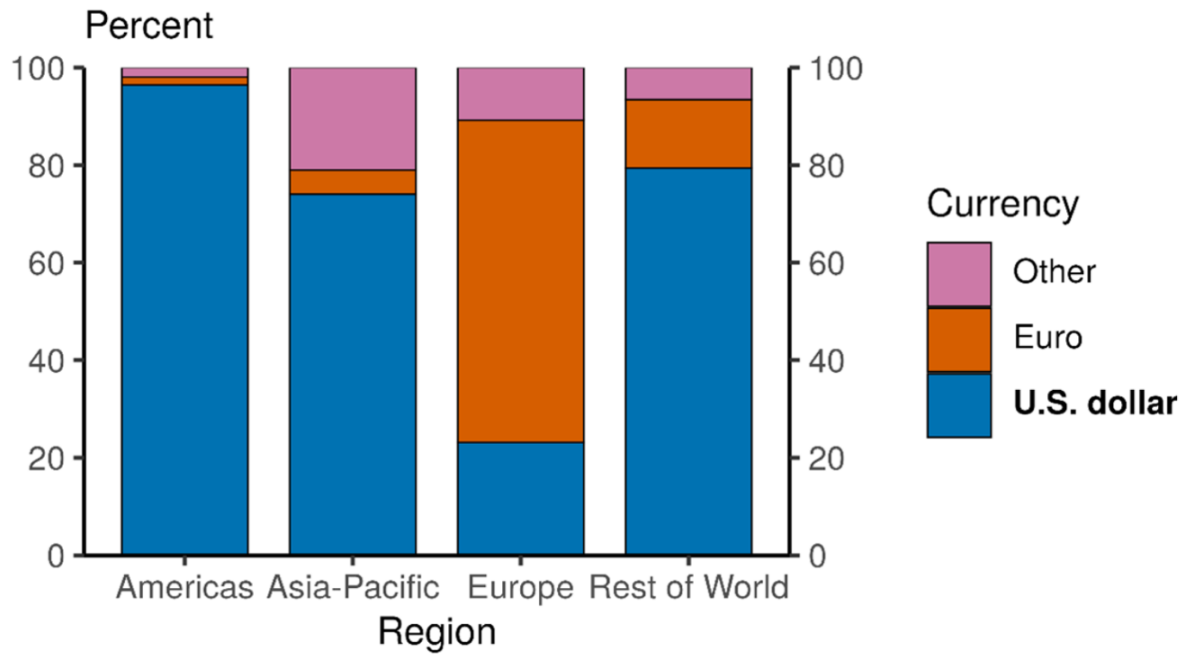
While most foreign-currency assets are held by individuals and businesses, governments also hold other nations' currencies, largely so that they can intervene to support their own currency in emergencies. The dollar's role as a *reserve* currency held by foreign governments accounts for only a fraction of its overall international role. Nonetheless, it attracts a lot of attention in part because government foreign exchange reserve holdings are relatively easy to track. The dollar isn't the only reserve currency,

but it accounts for almost 60 percent of government foreign exchange reserves worldwide:



*Unit of account:* A large part of world trade is invoiced in dollars — that is, contracts set prices and require payment in dollars. Indeed, the dollar dominates global invoicing except within Europe and when nations are trading with Europe:

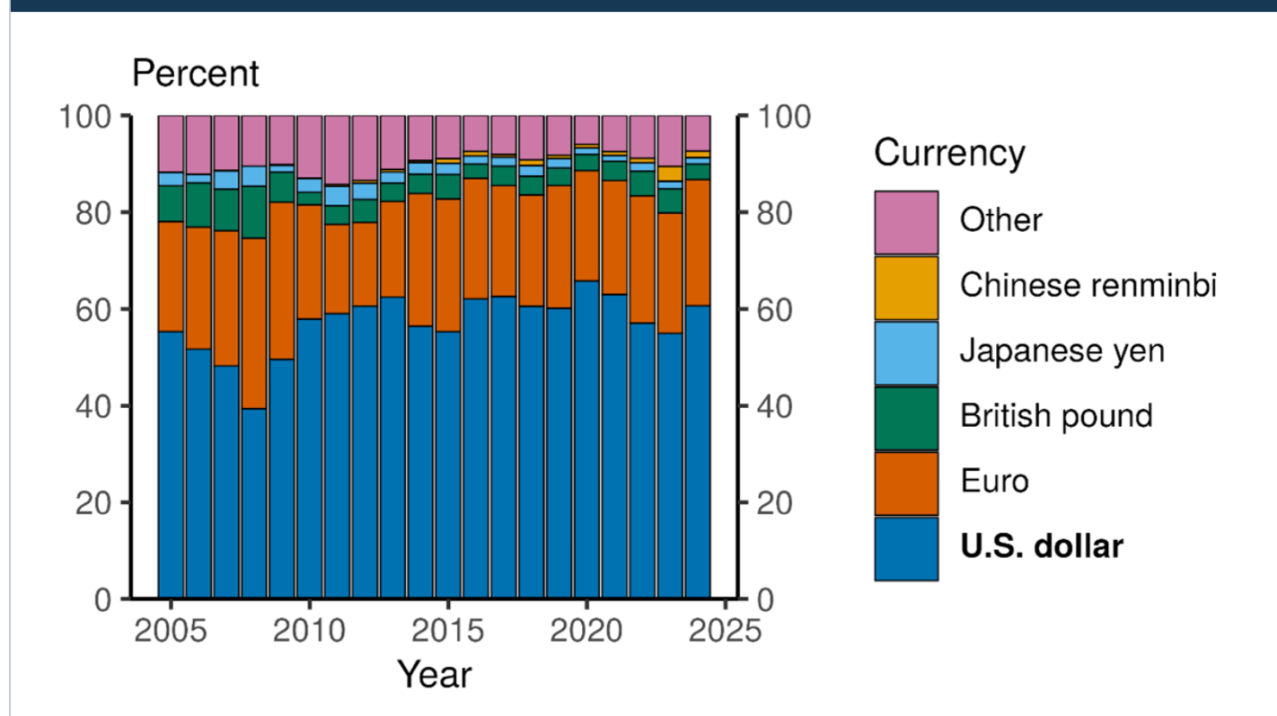
Figure 7. Share of export invoicing



Source: Federal Reserve

Foreign currency debt, which the Fed paper defines as “debt issued by firms in a currency other than that of their home country,” is also dominated by the dollar, with only the euro as a significant rival:

Figure 10. Share of foreign currency debt issuance



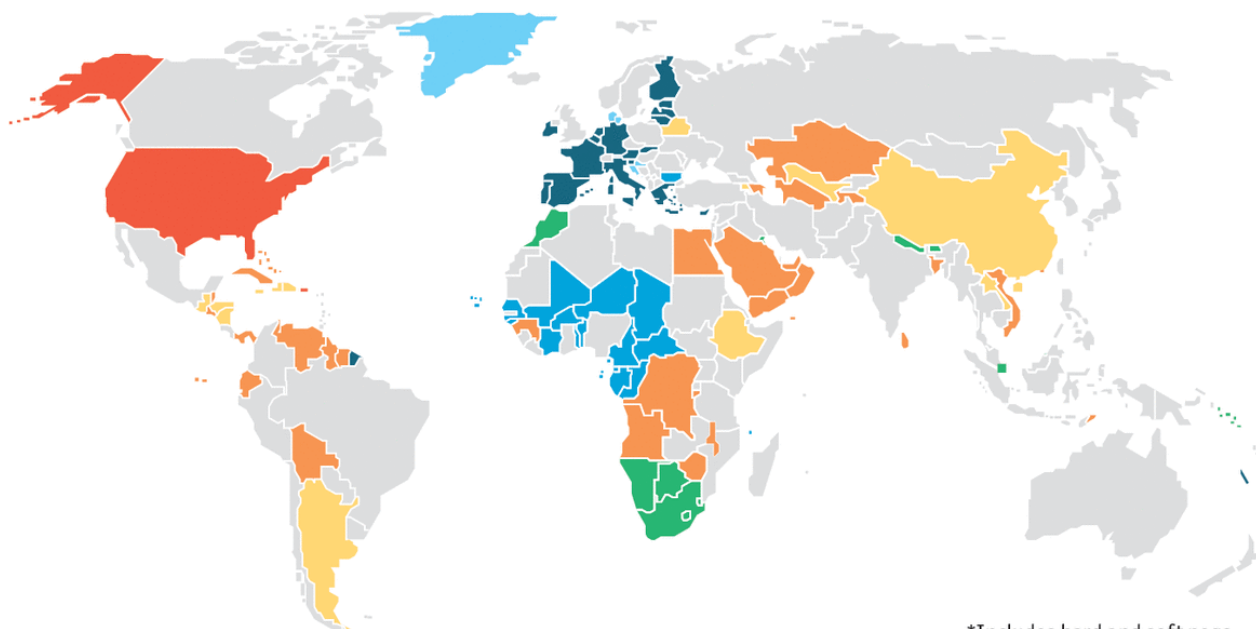
Source: Federal Reserve

Both invoicing and debt are examples of the dollar's role as a unit of account: import contracts and debts are denominated in dollars and debtors are required to pay an amount specified in dollars.

Once upon a time, the dollar also played a central role in the global exchange rate system. In the Bretton Woods system, which prevailed from 1944 to 1971, most market economies pegged the value of their currencies to the dollar. That is, they kept the value of their currency fixed relative to the dollar. With the demise of the Bretton Woods system, most countries switched from fixed to floating exchange rates, allowing markets to determine the value of their currencies. However, some dollar peggers remain, notably including Saudi Arabia:

## Currency pegs

- United States
- Currency pegged\* to US dollar
- Flexible† tie to US dollar
- Euro zone
- Currency pegged\* to euro
- Flexible† tie to euro
- Pegged to a basket of currencies or other single currency



Sources: Christoph Fischer; IMF

\*Includes hard and soft pegs  
†Looser (*crawling*) ties allowing for distinct monetary policy

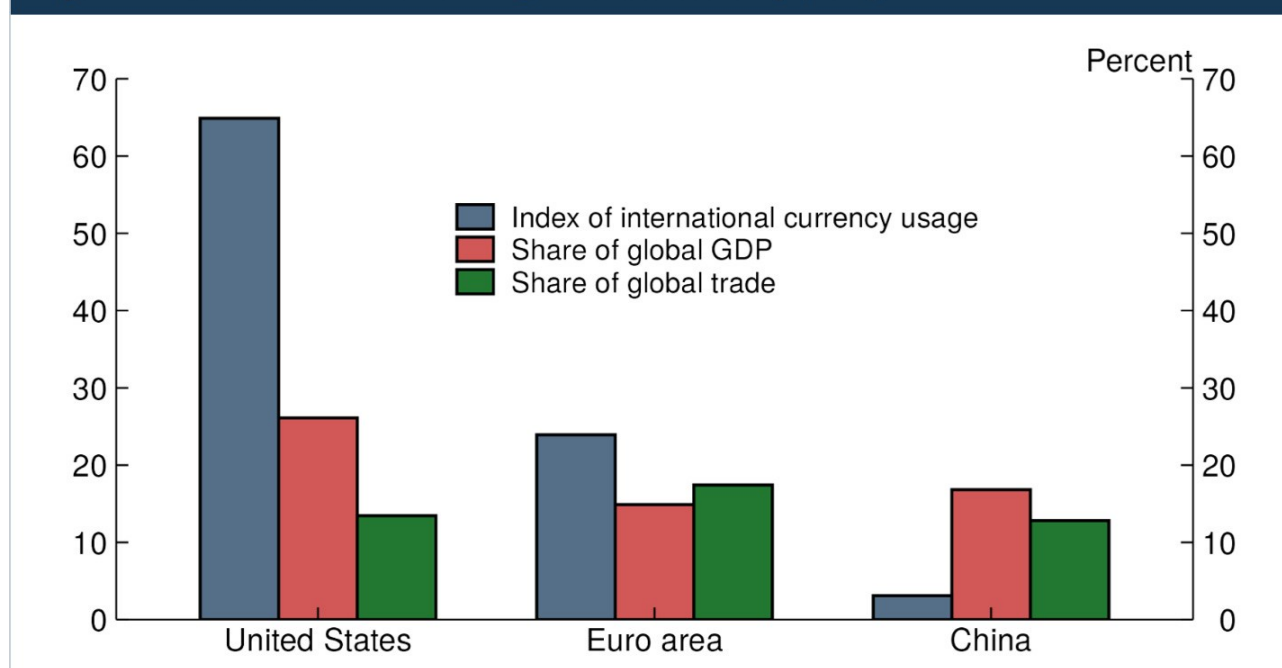
Economist.com

Source: The Economist

Put all of this together, and it's clear that the dollar does indeed play a dominant role in the world economy. It is the money of monies — as I said, it is to other currencies what money is to other goods and assets. No other currency comes close.

The Federal Reserve paper by Bertaut et al combines various indicators into a summary index of international currency usage. By this measure, the dollar is very much the dominant international currency, with the euro a distant second and the yuan barely registering:

Figure 1. International role of currency vs. size of economy (2024)



Source: Federal Reserve

### *Why does the dollar dominate?*

The U.S. has a very big economy, which runs on dollars and does a lot of business with the rest of the world, providing an incentive for foreigners to use dollars too. However, the euro area — European nations that have adopted the euro as their shared currency — and China also have big economies, and both play somewhat larger roles in global trade than the U.S.. Yet the international role of the dollar is far larger than the euro's role, and China's yuan barely rates at all. Why?

A significant part of the answer is that the U.S. financial system, which underpins the worldwide use of dollars, continues to enjoy major advantages over its rivals. Europe is in principle a unified market, but in practice it's still somewhat fragmented. Notably, the multiplicity of European government-issued bonds, with some considered safer than others, means that there is no benchmark euro-denominated safe asset comparable to U.S. government debt. And China still has capital controls — restrictions on moving funds into and out of the country — which makes the yuan highly problematic for international business.

But the most powerful force behind dollar dominance is the fact that the dollar is already dominant. The very fact that everyone uses dollars as money makes it easier to use dollars than any other currency.

There are several well-understood ways that this works. More than 40 years ago [I noted](#) that there was a self-reinforcing, circular logic to the dollar's role as a vehicle currency. (This was already widely understood, but I may have been the first to lay out a formal model.) People who want to exchange currencies such as reals and rupees use dollars because there are already large markets vis-à-vis the dollar, whereas trying to find other people wanting to make the reverse trade would be difficult. But markets vis-à-vis the dollar are large in part because everyone uses dollars.

A more recent theoretical literature developed by [Gita Gopinath](#) (former chief economist of the IMF) and co-authors explains invoicing and pricing behavior by pointing to “strategic complementarities” among businesses that often must set prices in advance. Loosely speaking, given uncertainty about the future, businesses often do best if they set prices in the same currency in which many other businesses set prices.

My favorite exposition of the logic of dominant currencies was actually in a [60-year old paper](#) by Charles Kindleberger that in an informal way encompasses all the modeling that has been done in the decades since. “The politics of international money and world language” argued that the role of the dollar as an international currency is analogous to the role of English as an international language. If a Brazilian business makes a deal with a business in, say, Malaysia, the negotiations will be conducted in English, because that's the common language of international business, and the deal will be invoiced in dollars, because that's the dominant currency of international exchange.

And the fact that people who want to do international business have to use English and dollars sustains and reinforces the dominance of both English and the dollar.

The language-currency analogy is also useful as a way of throwing cold water on breathless warnings about an imminent collapse in the dollar's role. If you find arguments that the yuan will displace the dollar very soon persuasive, ask yourself when you expect Mandarin to displace English as the language of international

commerce. The parallel isn't perfect, but it's strong enough that it should give you pause.

That said, global currency transitions do happen. The British pound was the dominant global currency before World War I and wasn't overtaken by the dollar until the 1930s. I'll turn shortly to the prospects for dollar displacement in the years ahead. But first, let's ask whether the dollar's dominant role confers special privileges.

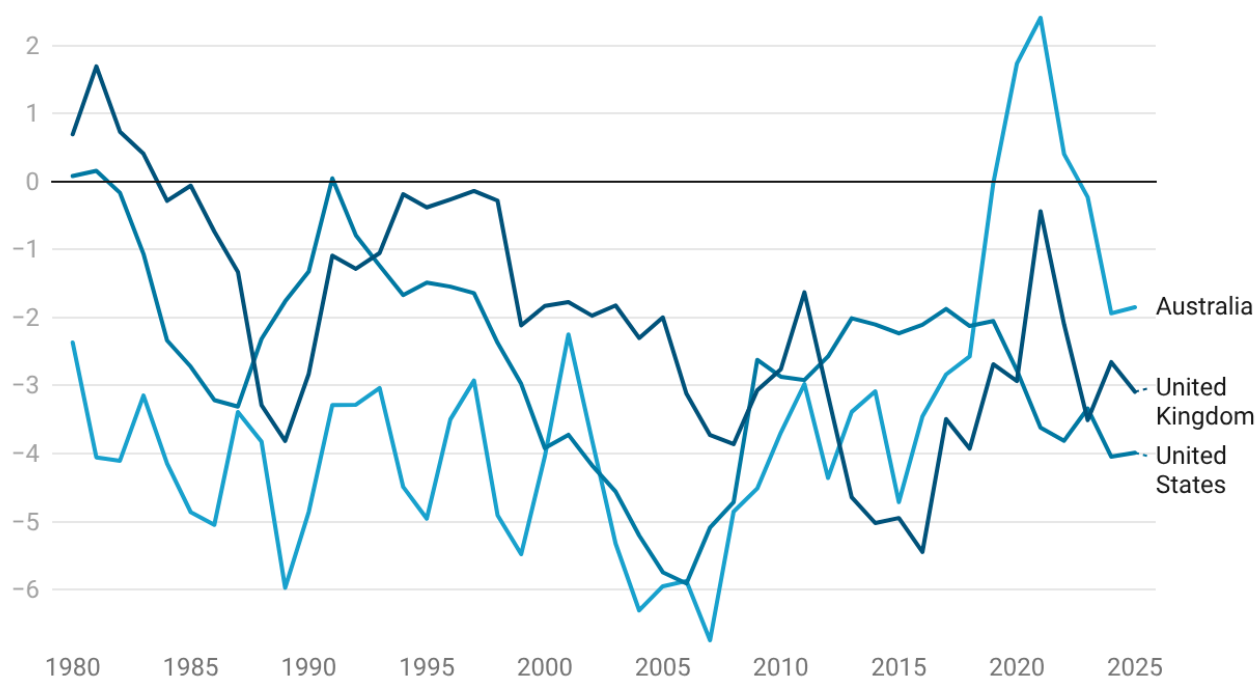
*Does dollar dominance convey special privileges?*

In the 1960s Giscard d'Estaing, then Charles de Gaulle's finance minister (he would later become France's president) denounced the "exorbitant privilege" that the United States derived from the international role of the dollar. There has ever since been a running debate among economists — with people I respect on both sides — about how much of a privilege owning the world's dominant currency actually conveys.

The very fact that we're still debating the point shows that the privilege, if it exists, is fairly subtle.

One still sees assertions that the dollar's role gives the U.S. a unique ability to run sustained trade deficits, because we can force the rest of the world to accept the dollars we print. But that's flatly untrue. Many countries are able to sell their debt on world markets, and this has allowed a number of nations to run large trade deficits year after year. Here, for example, are current account balances — a broad definition of the trade balance — for Australia, the UK and the US since 1980:

## Current account as % of GDP



Source: IMF • Created with Datawrapper

Australia ran huge deficits between 1980 and 2015. The UK has continued to run large deficits since 2000. America's ability to borrow large sums from abroad over a long period is by no means unique.

A weaker version of this hypothesis would be to claim that the dollar's special role allows the U.S. to borrow more cheaply than other nations. If this is true, the effect isn't large enough to be clear in the data. Ben Bernanke [examined this proposition](#) a decade ago, and found no evidence to that effect.

A subtler version — espoused, for example, by [Helene Rey and Pierre-Olivier Gourinchas](#) — is, to simplify their argument, that the dollar's role allows the U.S. to be what one might call a hedge fund nation, issuing a lot of debt while buying high-yield assets overseas. To be honest, I'm not sure what I believe on that front, although I take their analysis seriously.

One point in favor of exorbitant privilege is that the United States appears to earn a much higher rate of return on its investments abroad than other nations earn on their investments here. However, the key word may be "appears." At least some of the

apparent return differential is actually tax avoidance, with multinational corporations using accounting tricks to report profits actually earned in the United States in other jurisdictions with lower corporate tax rates.

I could go on; the question of the economic value of owning a dominant currency has been the subject of scores of research papers and will doubtless give rise to scores more. The bottom line, however, is that even if owning the dollar makes the U.S. richer, it's almost surely not a big effect relative to the immense size of our economy. So even if the dollar's role is under threat, that's not a big deal in terms of our economic future.

However, the United States does gain one exorbitant privilege from the dollar's role — a privilege that is more about power than about economics. Because so much of world trade and finance runs on dollars, businesses and banks must make use of the U.S. banking system even for transactions that don't directly involve the United States. This means that U.S. officials have the power to observe and, in some cases, block these transactions. In their eye-opening book "[Underground Empire](#)," Henry Farrell and Abraham Newman use U.S. exploitation of this power — notably to impose sanctions on Iran! — as their prime example of "weaponized interdependence."

A collapse of the dollar's special role would deprive the U.S. government of this power.

But how likely is a collapse of dollar dominance?

*What could dethrone the dollar?*

Dollar dominance has both broad and deep roots. The dollar plays multiple special roles in the world economy, involving all of the essential functions of money. Each of those roles is self-reinforcing — businesses transact in dollars because other businesses transact in dollars, businesses price in dollars because other businesses price in dollars — and mutually reinforcing: the dollar's dominance in each role supports its role in others.

So it would take a really major shock to dethrone the dollar.

Dominant-currency status isn't immutable. Before World War I the British pound was dominant. When Phileas Fogg set out to travel around the world in 80 days, he carried a carpet bag filled with pound notes, which he knew would be accepted in every nation. But by the time the world economy was being reconstructed after World War II, the dollar had taken the pound's place.

The displacement of the pound as the dominant currency was, however, brought about by extreme economic events. World War I brought major disruptions to world trade and finance. After a partial recovery in the 1920s, the Great Depression led to widespread adoption of currency controls that brought an end to traditional international economic relations. Britain itself adopted currency controls during World War II and maintained them for years after the war ended. Under these conditions the legacy of widespread global use of the pound sterling had little relevance.

And when “convertibility” — the right of businesses to convert domestic currency into foreign currency — was restored in the 1950s, the natural currency for everyone to use for international business was that of the era’s overwhelmingly dominant economic power, the United States.

Nothing comparable is on the horizon now. Compared with what happened to displace the pound between 1913 and 1950, Iran’s demand that Hormuz tolls be paid in yuan, although humiliating for the U.S., doesn’t rate at all.

I understand why many are willing to believe that U.S. fecklessness in foreign and trade policy, combined with the Iran debacle, will topple the dollar. But while we’ll pay prices on many fronts for recent policy madness, the end of dollar dominance won’t be one of those prices.