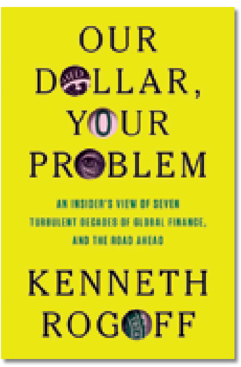
A Remarkable Inflection Point

Harvard economist Ken Rogoff talks about his compelling new book on the dollar with TIE*'s founder, editor, and publisher David Smick.*



Our Dollar, Your Problem: An Insider's View of Seven Turbulent Decades of Global Finance, and the Road Ahead *by **Kenneth Rogoff** (Yale University Press, 2025)*

Smick: What drove you to write the book? Was it the need to confront the myth you talk about of how real interest rates will somehow remain ultra-low forever in a world without inflationary risk? Forever?

Rogoff: I believe that this is a critical moment where having perspective on the global monetary system, both historical and economic, can be exceptionally valuable. This is particularly true right now when the global economy is at a remarkable inflection point. The popular belief that long-term real interest rates can be relied on to stay ultra-low forever is but one example of the perennial "this time is different" thinking that has always perplexed me.

The book covers the sometimes turbulent post-war rise of the dollar, its competitors and how other countries have learned to live with it, and also looks at the road ahead. Although hardly a memoir, I nevertheless lean into many critical junctures where I had an inside view not just of the policymaking process but of the development of the intellectual foundations that have helped shaped contemporary thinking.

Smick: Describe this in more detail.

A short list would include the fracturing of the global trading system, the sharp rise in populism across major advanced economies, an end to the era of ultra-low interest rates, the sustained deceleration in Chinese growth, and of course disruption from cryptocurrencies and artificial intelligence. Within the United States, the two parties are jointly tethered to unsustainable budget trajectories. Fed independence is no more

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popular with far-left progressive theorists than it is with Donald Trump, and would also have been vulnerable had Kamala Harris become president.

Smick: You describe the Federal Reserve as an island of technocratic competence in a sea of political turmoil, both domestic and international. Respond to Treasury Secretary Scott Bessent's description in the previous issue of this magazine. He sees the Fed as a mistake-prone institution with a weak forecasting record that allowed its quantitative easing and other crisis-related remedies to continue far beyond common sense. This blunder contributed to our immense problem of income inequality. What did you think of the Bessent article?

Rogoff: Well, I very much liked Bessent's piece, which echoes many of the critiques in my book, particularly when it comes to mission creep. Under pressure from the left (which dominates the universities that incubate Fed economists), the Federal Reserve system as a whole devoted significant resources to worrying about the environment, social justice, and inequality, areas where it lacks the requisite expertise, much less the requisite political legitimacy. I would, however, attribute this drift to having too little independence, not too much.

Today the challenge is Trump, but under Biden it was progressive ideology. Believe me, many key figures at the Fed understood this, and viewed bending with the wind as the lesser evil. And by the way, it is Congress and the president that have all the requisite tools to deal with inequality, and they are the ones who have the political legitimacy. I think it is wrong to put the situation at the doorstep of the Fed, whose main job should be to help maintain low inflation and stable growth.

However, when it comes to Bessent's critique of the Fed's interest rate policy—what should be its core independent function—there is a lot of Monday-morning quarterbacking going on here.

Yes, there have been mistakes, but if one looks at the post-1970s period when the Fed truly established its independence, do we seriously believe a system where the Fed is subordinate to the president and Congress would have done better on average in any dimension? Once the link between the dollar and gold was definitively broken in 1971 (the title of my book harkens to that era), it took years to find another device for anchoring inflation expectations. And although monetary rules are valuable, at the end of the day what one really relies on is having an independent Fed that resists political pressures and, in general, takes a "conservative" view of inflation, as I argued four decades ago. Last but not least, let's not forget that most market participants and the overwhelming majority of academic economists bought hook, line, and sinker into the "lower forever" theory of interest rates. So the Fed might not have realized, after the pandemic, just how far below equilibrium it was really setting its interest rates,

The global economy is at a remarkable inflection point.

Finally on QE, I again agree with Bessent. The Fed did a great job in the early days of the 2008–2009 financial crisis, finding creative approaches to dealing with market dysfunction, and preventing the financial system from collapsing even more than it did. But once calm had been restored, QE went on for much too long, and the Fed greatly oversold the benefits of what, when one looks at the consolidated government balance sheet, is simply maturity transformation.

Smick: To what extent will the dollar's future depend on global sentiment toward the concept of U.S. hegemony? Assuming Trump keeps being Trump, is the dollar vulnerable?

A QE Mistake

On quantitative easing, I agree with U.S. Treasury Secretary Bessent. The Fed did a great job in the early days of the 2008–2009 financial crisis, finding creative approaches to dealing with market dysfunction, and preventing the financial system from collapsing even more than it did. But once calm had been restored, QE went on for much too long, and the Fed greatly oversold the benefits of what, when one looks at the consolidated government balance sheet, is simply maturity transformation.

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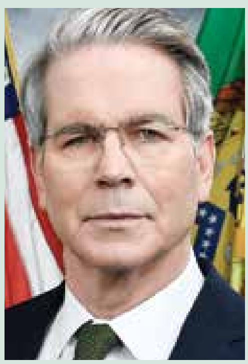

U.S. Treasury Secretary
Scott Bessent

Chinese President
Xi Jinping

Ronald Reagan? Not Any More

When Chinese leader Xi Jinping first came to power in 2013, my Chinese economist friends saw him as China's Ronald Reagan, ready to reduce state control and unleash market forces. In practice, Xi was unable or unwilling to radically reform the economy, and instead relied heavily on real estate and infrastructure to drive growth, long past the point of diminishing returns, a risk I had pointed out in my research over a decade ago. Today, the unwind, together with falling housing prices, is fueling a sustained consumption collapse much like the one that led to two lost decades in Japan.

—K. Rogoff

Rogoff: It is precisely distrust of the United States that has been slowly driving diversification away from the dollar for over a decade now. There are several dimensions to this, including the fact that the Fed's mandate has always amounted to putting America first, even when, say, a sharp rise in U.S. interest rates wreaks havoc elsewhere, or conversely when overly soft policy leads to a sudden rise in inflation. It may be our dollar, but it is your problem, as U.S. Treasury Secretary John Connally explained to his foreign counterparts after President Richard Nixon took the United States off gold in 1971, launching an era of inflation that greatly debased foreign dollar reserve holdings. In a perfect world, it may be efficient to have just the dollar, but in practice, a multi-polar world offers critical diversification.

Perhaps even more importantly, the United States has leveraged the global role of the dollar, as well as geopolitical dominance, to create a global financial system where many of the key "rails" of the global financial system run through the United States. This gives American authorities privileged access to data and information, and also allows them to unilaterally impose financial sanctions, which in recent decades have been used promiscuously. For Chinese authorities, who see what the United States is doing to Russia, this cannot be tolerated indefinitely, certainly if it intends to eventually, say, blockade Taiwan. Even Europe sees the United States' ability to invade its financial privacy and to unilaterally threaten European banks with financial sanctions as deeply problematic. That is why, over time, both China and Europe are working to develop alternative international clearing mechanisms, including central bank digital currencies, to circumvent U.S. monopoly.

As for Trump, his actions are hitting both sides of the dollar dominance equation, though on balance, his actions are accelerating the ongoing move toward a more multi-polar system. For starters, is naïve to think the United States can pull back from open trade without simultaneously affecting financial flows; as the book argues, the two are integrally related in general equilibrium. In the extreme, if the United States put up high-enough tariffs, the euro would by default become the main reserve currency. Whatever you think about Trump's push to make the president all-powerful, it is certainly undermines the legal system that foreigners put their trust in when they invest in the United States. The administration's flirtations with selective partial default such as in the Mar-a-Lago accord might be dismissed pure political rhetoric, but any foreign central bank reserve manager who dismisses them entirely is a fool. And looking longer-term, it raises the question of what a successor left-wing president, who will inherit all the presidential powers Trump establishes, might do to foreign creditors, not to mention domestic wealth holders. Attacks on Federal Reserve independence raise the prospect of future inflation, again if not under Trump, then under a successor. The big, beautiful bill, together with an unwillingness to rein in old-age entitlement programs, puts the country one step closer to an eventual fiscal crisis.

I very much liked Bessent's piece, which echoes many of the critiques in my book, particularly when it comes to mission creep.

On the other side of the equation, Trump's forceful thrust to strengthen U.S. dominance in artificial intelligence is a huge plus for the dollar, albeit one that comes at grave risk. A regulation-lite approach comes with myriad risks to social and economic stability, not to mention existential risks to humanity, risks which should require more thought and oversight of AI development. More narrowly, the administration's stablecoin legislation could potentially lead to a significant increase in demand for U.S. Treasury-bill backed assets, although the regulation-lite approach is rushing things along at the cost of significant risks.

Smick: Paul Blustein in his recent book *King Dollar* takes a more optimistic view of the dollar's permanence than your book. Blustein says what convinced him was when he examined Bank for International Settlements data regarding foreign exchange swaps, an obscure but massive market. Says Blustein, "The dollar is by far the main currency used. The big firms use this market to hedge themselves so they can use dollars for all kinds of purposes." When you see the size of that data, it's hard to see the dollar being taken down short of some monumental catastrophe, he says. Do you buy this argument?

Rogoff: Measuring dollar dominance one feature at a time is a bit like the parable of the six blind men touching an elephant in different places. Each reaches a conclusion based only on their own experience—the one who touches the trunk thinks it is a snake, and so forth. There are many other measures of dollar dominance, including the composition of central bank reserve holdings, the pricing of goods in international trade, the extent to which foreign firms and governments borrow in dollars, and more, and they don't all tell the same story. Central banks, for example, have slowly but steadily been diversifying away from the dollar. My favored measure is the share of countries that either anchor their currency to the dollar or have it as their reference currency. This can be considered a portmanteau measure in that most central banks are keenly aware of the broad array of channels through which the dollar influences their economy, for example liability dollarization. By this measure, the dollar peaked in 2015 and was in slow decline even before Trump.

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The BIS swap data is an old chestnut; one I discuss early on in my book. However, it is also an example where network effects are particularly acute and where diversification and inflation risk do not matter much since these are super short-term trades. So the 90 percent figure is, with all due respect to Paul's excellent book, just one part of the elephant.

Smick: U.S. Treasury officials suggest the Chinese have been dominant buyers of gold for the precise purpose of someday establishing a gold-backed alternative to the dollar as the heart of a new Asia-wide trade zone. The Chinese currency would not be tied to gold but presumably Beijing would have significant controlling influence. Does this move make sense to you? For the West? For China?

Rogoff: The U.S. authorities are right to worry about the renminbi eventually becoming the main regional currency in Asia, which now constitutes roughly half the dollar bloc. (Europe, once the mainstay of the dollar bloc, is no longer a part of it.)

Whereas it makes eminent sense for China to accumulate gold as hedge against dollar depreciation and U.S. sanctions, it will play only a very secondary role in backing the renminbi as it continues to separate from the dollar. Rather, foreign holders of renminbi will be depending on the Chinese government's ability to credibility sustain a low-inflation monetary policy, and to honor its foreign debts. The spread of the renminbi does not require China to have fully open capital markets as long as the bond market is large and reasonably liquid. It is, by the way, a misconception to think that China will need to run current account deficits in order to seed the world with renminbi bonds. Chinese purchases of international assets can also do the job. And by the way, the United States often ran surpluses in the decades after World War II.

The cryptocurrency world is abuzz in the belief that China and other central banks might eventually turn to Bitcoin as a reserve asset in addition to gold. This is unlikely in the foreseeable future, though in the event of more intense geopolitical fracturing or a dystopian AI future, it is not out of the question.

Smick: Your book presents a wonderfully thorough review of the history of the Chinese economic and financial systems. One theory is that if you were a Martian who visited planet Earth and stayed the last seven or eight years, you would have no choice but assume China's leader Xi Jinping, while a master political infighter, is

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economically inept in the management of his economy. An incompetent. Goodwill toward China was running high as the belief was that China would behave responsibly at the World Trade Organization. Never happened. Instead, the opposite occurred. Then Xi refused to stimulate consumer demand, which left the economy too heavily dependent on investment and exports at a time when tariffs and growing distrust of Beijing's intentions were both on the rise. Do you in any way buy this argument—that Xi blew the call?

Most market participants and the overwhelming majority of academic economists bought hook, line, and sinker into the "lower forever" theory of interest rates.

Rogoff: When Xi first came to power in 2013, my Chinese economist friends saw him as China's Ronald Reagan, ready to reduce state control and unleash market forces. In practice, Xi was unable or unwilling to radically reform the economy, and instead relied heavily on real estate and infrastructure to drive growth, long past the point of diminishing returns, a risk I had pointed out in my research over a decade ago. Today, the unwind, together with falling housing prices, is fueling a sustained consumption collapse much like the one that led to two lost decades in Japan. Having increasingly surrounded himself with loyalists instead of technocrats (sound familiar?), there is certainly heightened risk of big mistakes should the economy take yet another leg down.

If one wanted to say that Xi has all along been playing four-dimensional chess, the story would be that he quickly came to realize that China's growth was not sustainable, and economics liberalization was not feasible while maintaining the absolute primacy of the Communist party. So instead, he concentrated on consolidating power to maintain stability and control, even if it meant exacerbating the inevitable slowdown. Of course, had Xi instead been willing to allow China to gradually become more democratic, we might be living in a very different world, one where globalization would likely still be advancing instead of being at risk of retreat.

Smick: Did Germany make a long-term mistake giving up on its debt "brake" even as the use of EU-Bonds is about to explode? What are your expectations for the economy of the eurozone in the next five years? For the euro?

Rogoff: One of the first Trump term's best ideas was to force Europe to take far greater responsibility for its own defense and it will be one of Trump's signature achievements in his second term if this actually happens. But Americans must realize that if a geopolitically relevant Europe ever does emerge, it will surely boost the international statue of the euro, as my book discusses. For all the drawbacks of having to pay for defense at the expense of the welfare state, there will also be benefits to Europe's economy, in part because military applications often push the cutting edge of technology. It will also force Europe to make a host of other accommodations to geopolitical reality. I was sitting in the audience at Davos last January and watched all the Europeans' jaws drop when Trump announced his intent to double U.S. electricity production to accommodate AI.

It is also notable that much of the dollar's gain in the early 2010s came at the expense of the euro, when the region was mired in the European debt crisis. One already

The Costs of Increased European Defense Spending

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sees the euro's market share in global central bank reserves creeping back up to 21 percent; it is likely to pass its previous peak of 25 percent. People sometimes say to me, doesn't the eurozone still have all the same problems it always did (lack of a fiscal union, lack of a capital markets union, splintered bond markets, and so forth). Well, yes, but in a sports match, when the stronger team loses important players to injuries, the weaker team can win even if it has not become any better in an absolute sense.

Smick: Do you see stablecoins playing some role in maintaining the crucial importance of the dollar?

Rogoff: Yes, the growth of stablecoins, which for now are almost all dollar-based, definitely helps the dollar *vis-à-vis* other currencies. However, let's not get too excited, Estimates of the net effect of stablecoins on the demand for U.S. Treasuries (Bessent's article mentions $2 trillion over the next couple years) are perhaps optimistic. Yes, stablecoins are going to attract many adherents, but a fair chunk of this demand will come from legacy money market funds and bank deposits, thereby shifting one form of demand for Treasury bills to another. There could also be a long and painful transition period, as runs and bankruptcies weed out the vast majority of stablecoins, leaving just two or three dominant ones.

Another very important issue is how to prevent stablecoins from becoming vehicles for tax evasion, money laundering, and illegal activity, especially as the new regulations so strongly favor privacy over auditability and identity. Indeed, I strongly suspect the GENIUS Act will not be the last word on the topic. The effects on tax evasion in the United States alone could easily outweigh the benefits the Treasury hopes to gain by spurring demand for U.S. bonds. Once regulators realize that, and force more auditability on state-sanctioned stablecoins, the sharp differences with central bank digital currencies will be less conspicuous. And this will be all the more so, as two or three major private players come to dominate. Thus, even though the euro and renminbi central bank digital currencies seem to be stuck at the starting gate right now, I would not rule them out. Indeed, it is quite possible that even in the United States, the long run will involve a two-tier system with a wholesale central bank digital currency and tokenized bank deposits.

Smick: In a related question, to what extent does the depth of U.S. financial markets, particularly the market for U.S. Treasury debt, affect the dollar's future?

Rogoff: Liquidity is massive advantage to the dollar, although over time, Europe will likely find a way to consolidate its debt, and Chinese treasury bonds will become ever-easier to trade. One must also consider that part of the U.S. advantage in debt liquidity is that there is so much of it, with marketable U.S. government debt being of the same order of magnitude as the debts of all the other major advanced economies combined. The scale and growth of U.S. government debt may help dollar liquidity but it is also the dollar's Achilles heel. At today's long-run real interest rates, the notion that debt is a free lunch (which a remarkable number of thought leaders in economic policy came to believe) will look increasingly naïve.

Smick: Describe a scenario of catastrophe where the world finally loses faith in the dollar.

Rogoff: To be clear, my book paints a picture of how the dollar's market share could fall over the coming decade or two, leading to a more multi-polar system. The dollar may remain on top, but it will be king of a smaller hill. The United States will have to pay higher interest rates and will find that its control over world financial data and its ability to impose sanctions are sharply diminished. Beyond that, the dollar is not going anywhere unless the United States suffers crippling defeat in a major war, which is not going to happen anytime soon. Much sooner though, perhaps even in the next four to five years, a debt crisis in the United States could lead to a mix of inflation and financial repression (and even partial default) that leads to a long period of inflation, interest rate instability, and exchange rate instability, all of which will also spill over into a global rise in country debt and financial crises.

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Smick: Thank you very much. Good luck with the book. ◆