The fight to dethrone the dollar.

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In 2018, European officials watched President Donald Trump blow up a nuclear deal with Iran, reimpose sweeping sanctions and mull disconnecting its banks from SWIFT. They had had enough. America was using its financial hegemony to muscle allies into punishing its latest victim. European firms were fleeing Iran for fear of secondary sanctions from America.

Britain, France and Germany decided to put up a fight. Their answer was the "Instrument in Support of Trade Exchanges" (INSTEX), a barter system that could support humanitarian trade with Iran without any recourse to the dollar. Seven more EU states signed up. In March 2020 INSTEX's inaugural transaction supported a sale of medical goods to Iran.

This is the fifth chapter in a six-chapter special reportThe global financial system is in danger of fragmenting How crises reshaped the world financial system The movement of capital globally is in decline National payment systems are proliferating The fight to dethrone the dollar How the financial system would respond to a superpower war

But INSTEX's debut trade turned out to be its last. The Islamic Republic blocked multiple proposed deals. European firms feared that bartering alone might incur America's wrath. INSTEX quietly folded in 2023, three years after it opened. Instead of offering an alternative to the dollar, it ended up highlighting the unassailability of the greenback's position.

The episode captured in microcosm the scramble to erode the dollar's pre-eminence. The world has many reasons to want strong alternative options. An erratic Washington has turned forecasting long-run economic policy—and thus the dollar's value—into a mug's game. Politicians engage in periodic stand-offs over whether to lift a cap on the national debt which, if not lifted, could result in a default, endangering Treasury bonds' status as the world's safest asset. Over the past few years, the Federal Reserve has allowed inflation to rise more dramatically than at any time since the 1980s, and has yet to bring it fully under control.

Yet in spite of these incentives to shun the dollar, no other contender has come close to stealing its crown as the world's reserve currency. Instead, argues Eswar Prasad of the Brookings Institution, the real jockeying for position has taken place among other currencies—a process he calls "fragmentation of the second tier". Counterintuitively, even as the reasons to avoid it have piled up, the dollar's dominance over its nearest competitors has grown stronger than ever.

If you liked it you should have put a ringgit on it

Nowhere is this more obvious than in the proportion of currency trades involving the greenback. Since the turn of the 21st century this has held steady at between 85% and 90%. Part of that ubiquity derives from the dollar's use in global payments, trade and capital flows. But it is also linked to the central role the currency takes for foreign-exchange dealers. If you want to sell pounds sterling for yen, you can do so directly; if it is ringgits for zlotys, you might struggle. Instead, you would sell the ringgits for dollars and then use those to buy the zlotys. The FX market benefits if a single currency assumes this linchpin-like role, as it allows separate pools of liquidity for more rarely traded counterparts to be grouped together.

Meanwhile the fortunes of other currencies have fluctuated. In 2001 the euro was a rising contender: it was used in a bloc of countries with comparable economic output to America, and was present in 38% of FX trades. But over the next two decades, as other currencies like China's yuan became more widely used, they bit chunks out of the euro's share of transactions—more than they did from the dollar's. By 2022 the euro's share had dropped to 31%. The Japanese yen fared similarly. And so the dollar's lead over its closest rivals grew. In recent years, so has its use in cross-border payments. It accounted for 47% of those made via SWIFT in January, up from 38% three years earlier.

Similar trends are apparent in the currency split of central bank reserves. Such foreign-exchange reserves exist to be deployed during times of turbulence or crisis. That means they must be able to be sold at the drop of a hat, and should ideally comprise a mixture of the domestic currency's biggest trading counterparts.

These incentives ensure that, once again, the dollar wins (see chart). Although the euro's share rose in the decade after its creation, to 28% in 2009 compared with the greenback's 62%, it tumbled after the ensuing euro-zone debt crisis, to 20% in 2023 against the dollar's 58%. The yuan and the Australian and Canadian dollars each grew to more than 2% of reserves. But as with the FX market, their rise came at the expense of the greenback's top competitors.

The dollar's preponderance has held even in the face of the West's immobilisation of the Central Bank of Russia's foreign-exchange reserves, in 2022. America's geopolitical rivals might want alternatives, but none could match the dollar's liquidity or centrality in global trade. They would thus be worse at fulfilling the stabilising function of reserves in the first place.

The dollar's appeal looks durable in other ways. Unparalleled demand lowers interest rates on dollar debt, making it the preferred choice for firms and governments borrowing in foreign currencies. (Roughly half of all cross-border bank loans and debt securities are denominated in dollars.) A common faith that the Fed has more firepower than other central banks ensures that the dollar strengthens in a crisis even if, as in 2008, the worst of the trouble emanates from America itself. That in turn means that dollar assets, especially Treasury bonds, are seen as safer than others and so are considered more useful as collateral.

Efforts to promote whizzier alternatives have faltered. Cryptocurrencies such as bitcoin are subject to wild swings in value, making them unreliable units of account or stores of value—two crucial functions for a currency. The digital "stablecoins" that have overcome this deficiency via pegs to proper currencies are more useful. But only those linked to the dollar (and therefore ultimately relying on dollar payments) have gained anything approaching widespread use.

Central banks are gradually starting to mint their own digital currencies. The biggest pilot project, the People's Bank of China's digital yuan, had hit a total transaction volume of just 1.8trn yuan ($250bn) by June 2023. Even if such digital currencies do take off, at least one would need to show how it could be uniquely useful—and well ahead of America doing so—to yield a meaningful advantage over the greenback.

Uncommon currency

Other potential threats to the dollar still loom. The growth of alternative payment systems, and of transactions that have no need for the dollar, could accelerate, due either to overreach by Western sanctions or network effects from rising membership. Should China's CIPS be the main beneficiary, the yuan's fortunes might soar (though capital controls would make foreign central banks wary of relying on it as a reserve currency). For now, even within China, last year was the first in which cross-border payments in yuan edged past those made in the dollar.

Judging by the world's previous reserve currency—the pound sterling, which declined for decades before being superseded by the dollar—such changes are likely to proceed at a glacial pace. That is, unless the transformations of the global financial system examined in this report are supercharged by a new crisis.

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