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Bretton Woods III: The Dethronement of the Dollar



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Abstract

This research paper examines the potential shifts in the global monetary order, particularly the feasibility of moving beyond the current dominance of the U.S. dollar towards alternative currency standards. The study analyses theoretical frameworks and practical implications of adopting new monetary systems, with a focus on the roles of established currencies such as the Euro and the Chinese Renminbi, Central Bank Digital Currencies (CBDCs), and cryptocurrencies. Employing qualitative methods and interviews with monetary experts and scholars, the research assesses the durability of the Bretton Woods II system and explores the conceptualization of a Bretton Woods III scenario, where a diversification of global monetary leadership could occur. The analysis critiques the ongoing supremacy of the dollar amidst shifts in geopolitical power and advances in technology, evaluating the capacity of the euro and renminbi to challenge this dominance alongside emerging digital currencies. Based on findings about the aforementioned elements, the research concludes that there are undisputable signs of the crumbling dollar dominance even if not in the near future the world is heading towards polycentric monetary world order.

I. Introduction

“Our currency, your problem”

John Connely, U.S Treasury Secretary (1971)

In the intertwining landscape of global finance and trade, the dominance of the U.S. dollar has stood as a cornerstone of the international monetary system since the mid-20th century. Established under the Bretton Woods Agreement in 1944, the dollar's supremacy has facilitated international trade, investment, and economic stability. However, as geopolitical shifts reshape global power dynamics and technological advancements redefine interactions within financial markets, questions about the sustainability of the dollar's hegemony and the feasibility of a new monetary world order become increasingly important.

This paper seeks to explore these questions by examining potential shifts towards a diversified global currency system, where the Chinese renminbi may emerge as significant contenders against the dollar's dominance. The analysis also considers the transformative potential of innovative financial technologies, including Central Bank Digital Currencies (CBDCs) and cryptocurrencies, which could disrupt or redefine traditional monetary practices. The research adopts a qualitative methodology, employing expert interviews and theoretical analysis to scrutinize the structure and resilience of the Bretton Woods II system. It hypothesizes the formation of a Bretton Woods III scenario— a theoretical framework where a multipolar currency regime could foster a more divided but stable global economic environment. This introduction to a new monetary era considers the increasing economic influence of China, alongside the sprawling impact of digital currencies on global finance. By evaluating the current roles and future potential of the renminbi, this paper aims to assess its capacity to challenge the U.S. dollar's status as the world's primary reserve currency. Furthermore, it investigates how emerging digital currencies, through their unique properties and growing acceptance, might complement or compete within this evolving monetary landscape. This study is positioned at the nexus of economic theory and policy implications, seeking to provide a comprehensive perspective on the future of global monetary systems. It endeavours to contribute to the policy debates and strategic planning of financial institutions, governments, and international bodies as they navigate the complexities of an evolving global economic order.

The paper is structured into distinct sections to facilitate a detailed examination of the research. The *“Literature Review”* synthesizes historical and current insights into international currencies, trends and shifts. The *“Methodology”* section outlines the qualitative research

techniques used in this paper. In the part “*Findings*”, the potential for shifting away from U.S. and the dollar dominance is discussed, touching upon with insights regarding feasible solutions for alternative currencies. The “*Conclusion*” part intends to summarize the findings of this paper while highlighting the limitations of this research.

II. Literature Review

II.1. Characteristics of an International Currency

The international monetary system is characterised by three crucial elements: adjustment, liquidity, and confidence. Adjustment refers to the strategies that governments adopt to address external imbalances. Liquidity refers to the extent to which reserves can be utilised to engage in the foreign exchange market. Liquidity is not inherent in freely floating exchange rates as monetary authorities do not require reserves to operate in foreign-exchange markets. Insufficient reserves compel governments to shrink their economy, resulting in less imports and reduced deficits. Alternatively, they may raise interest rates (which can also have a recessionary effect) to attract financial inflows. Confidence refers to the level of trust that nations place in the international monetary system, which encompasses the perceived fairness of the adjustment process and their readiness to maintain sufficient reserves to address imbalances (Grubel, 1969). Black (1985) concludes a new approach by saying that the international applications of a currency involve its use in invoicing imports and exports, as a standard measure for accounting purposes, for denominating cross-border assets and liabilities, as a currency used in foreign exchange markets to facilitate transactions and reduce costs, and as a component of official foreign exchange reserves. Hartmann (1998) adds to this by making a parallel between the many applications of a currency, both internationally and domestically. It specifically focuses on its role as a medium of exchange, unit of account, and store of value. Additionally, it highlights the differences between private and official usage of a currency at the international level. Therefore, the private utilisation of a currency as a means of conducting transactions would involve its usage for both the exchange of goods (including international trade as well as, in certain instances, solely domestic trade, where the domestic currency is replaced by the foreign currency) and the exchange of different currencies (Hartmann, 1998). Lastly Dobson and Masson (2009) conclude that an international currency functions as a unit of account when it is used to quote prices in private transactions or formally as a reference currency. The store of value function pertains to the private use of a currency as an investment or as an official part of foreign exchange reserves (Dobson and Masson, 2009).

According to the Organisation for Economic Co-operation and Development (OECD) (2024), reserve assets refer to assets that are easily accessible and under the jurisdiction of monetary authorities, used for directly funding payment imbalances. Reserve assets include several forms of wealth held by countries to maintain financial stability. These assets include monetary gold, SDRs, reserve positions in the International Monetary Fund (IMF), foreign exchange assets such as currencies, deposits, and securities, as well as other claims. The measurement of this indicator is expressed in SDRs. The IMF calculates the value of SDRs on a daily basis by aggregating the United States Dollar (USD) value, determined by market exchange rates, of a carefully selected combination of currencies. The basket and weights are subject to regular updates (OECD, 2024). In addition to holdings of foreign assets in government securities, such as bonds and gold, that may be quickly changed into cash, a nation's foreign exchange reserves consist of its holdings of other nations' currencies that can be converted into its own currency through the foreign exchange market. Foreign currency reserves are another name for foreign exchange reserves. This is due to the fact that these often consist of stockpiles of currencies belonging to other nations that are stored in the vaults or accounts of a respective nation's central bank. A nation's foreign exchange reserves are a component of its reserve assets and are utilised for the purpose of diversifying the portfolio of international reserves that the nation maintains. It is common practice for many nations to maintain reserves of the United States dollar in addition to a variety of other currencies, such as euros, yen, Swiss francs, and British pounds sterling together with the United States dollar. By way of illustration, Japan is able to purchase its own currency, the yen, by drawing from its own reserves of the United States dollar. Euros and yen make up the United States' greatest reserves of foreign currency, according to the United States (Diongson, 2022).

II.2. Bretton Woods I

During the nineteenth century, an increasing number of countries began to use gold as the benchmark for their monetary systems. Britain's early adoption of the gold standard served as a central reference point for other countries (Eichengreen, 2022). The international gold standard, often considered a hallmark of economic stability, actually has a more complex and relatively recent origin than commonly thought. Originating in Britain post-Napoleonic Wars, it evolved into a true international standard following the Franco-German War. It wasn't until the close of the 19th century that the U.S. cemented the gold standard firmly at the heart of its monetary system. This gold-based system was the backbone of international finance until the start of World War I in 1914, which precipitated its downfall (Cassel, 2017). During the 1920s,

international monetary developments were primarily influenced by the interplay between the effects of war and the objective of reinstating the gold standard, despite the absence of favourable conditions for attaining this goal quickly and without significant negative impacts on welfare. The sequence of events may be divided into three distinct phases. The first phase was the use of floating exchange rates, which came to an end when Britain returned to the gold standard in April 1925. This was followed by a brief period of fixed exchange rates, which lasted until September 1931 when sterling abandoned the gold standard. The third phase involved the use of controlled floating exchange rates, which continued until the onset of World War II. An alternative viewpoint places greater importance on a chronological categorization of monetary processes, specifically emphasising the norms and characteristics of the system rather than the exchange rate regime (Cesarano, 2006).

The Bretton Woods system, established in July 1944, is one of the most fundamental steps towards the world economy as we know it today. The objective of this global conference was to develop a post-war framework that would ensure thriving international trade and strong economies. The meeting led to the formation of the post-war fixed exchange-rate system and the foundation of the International Monetary Fund and the World Bank. As World War II advanced, it became more and more evident that the Allies would emerge victorious. The governments of the United States and Great Britain, the primary Western allies, were eager to establish a new monetary and economic system that would prevent the recurrence of the severe economic crisis of the 1930s, known as the Great Depression. Economists, specifically attributed the lack of continuous international trade as a significant influence on the economic conditions that precipitated the Depression. In order to mitigate economic disruptions, it was necessary to establish institutions capable of maintaining stable monetary exchange rates in the face of extensive trade (Gordon, Nancy M, 2021).

Two extremely influential financial institutions had been established: the International Monetary Fund (IMF) and the World Bank, which later evolved to an organisation focused on reconstructing the economy of war-torn Western countries to an organisation aimed at fostering economic growth in underdeveloped economies. The Bretton Woods agreement was primarily conceived by two economists: the internationally acclaimed John Maynard Keynes, who represented the British government throughout the discussions, and Harry Dexter White, a relatively unknown American economist working for the U.S. Treasury. Another major aspect of the system was the currency convertibility. The year 1958 marked the beginning of the complete operation of the Bretton Woods system, which was the year when currencies became

convertible. The United States dollar, which could be exchanged for gold at a set rate of \$35 per ounce, was used by nations around the world to complete their existing financial commitments. In order to ensure that there is continuous faith in the capacity to convert gold in the future, the United States had been entrusted with the responsibility of maintaining a fixed price for gold and must restrict the quantity of dollars (Ghizoni, 2013).

In the early 1960s, the set price of the United States dollar in relation to gold, which was established under the Bretton Woods system of fixed exchange rates, was seen to be excessively high. The overvaluation of the dollar was progressively made worse by a number of factors, including a significant increase in domestic expenditure on programmes that were part of President Lyndon Johnson's Great Society and an increase in military spending that was brought on by the Vietnam War (IMF, 2008). The conventional Bretton Woods system ended in August 1971. The demise of the gold standard system might be attributed to mutual arguments and recriminations on the responsibility for adjustment, essentially due to the lack of a really efficient mechanism for multilateral surveillance. The primary reason for its destruction was the lack of adaptability inside the system at a fundamental level. The exchange rates had become more rigid, making it impossible to consider any changes until there was a significant crisis. Additionally, other types of adjustments, such as fiscal policy changes, were politically controversial. The system was dismantled due to a specific cause: the monetary expansion of the United States in the late 1960s, which was linked to the Viet Nam conflict, and a lenient monetary policy during the exchange crisis in 1971. The critique that General de Gaulle had articulated most persuasively in the mid-1960s suddenly appeared justified by the way in which the breakdown occurred. Furthermore, the higher influx of money served as the catalyst that exposed the incompatibility of various national policy positions inside the system (James, 1996).

It is widely believed in the United States that France played an important part in the collapse of the Bretton Woods international monetary system. According to this popular perspective, the French initiated a systematic strategy of changing their dollar assets into gold in 1965. The erosion of faith in the dollar was caused by the pressure on U.S. gold reserves, which ultimately led to the collapse of the system. This analysis of France's foreign monetary measures between 1960 and 1968 suggests that French policy was driven by President de Gaulle's anti-American political agenda rather than any rational economic aims. President de Gaulle of France had already initiated a formidable challenge to Bretton Woods and, by extension, to the United States. The French have always shown their sensitivity against perceived infringements on their

autonomy and a strong aversion to what they regard as the economic hegemony of the United States over Europe (Volcker and Gyohten, 1992, p. 42).

II.3. Theory of Bretton Woods II

Before getting into the theoretical background of Bretton Woods II let's look at some of the fundamental terminology that is necessary to use in this section such as the current account or the impossible trinity.

The current account, which includes the net exports of goods and services and unrequited transfers balances, may be calculated using the national income accounts. The latter demonstrates the primary connection between the current account balance and capital flows and may be computed by subtracting private investments from private savings and tax receipts from government spending (Işık et al, 2017).

The Mundell-Fleming framework makes a crucial addition by introducing the concept of the impossible trinity, sometimes known as the trilemma. According to this concept, a country can only achieve two out of the three goals: monetary independence, exchange rate stability, and financial integration. Each side of the triangle represents a desirable objective: monetary independence, exchange rate stability, and financial integration. However, it is not feasible to achieve all three objectives simultaneously. The closed capital markets, is linked to the autonomy of monetary policy and a fixed exchange rate system, but it does not involve financial integration. This was the chosen option for the majority of developing nations throughout the mid to late 1980s.¹ In the past two decades, the majority of emerging nations have chosen to pursue greater financial integration. The trilemma suggests that a nation faced with this choice must either sacrifice stability in its exchange rate in order to maintain some level of control over its monetary policy or sacrifice its capacity to control its monetary policy in order to maintain stability in its exchange rate (Aizenman et al, 2008).

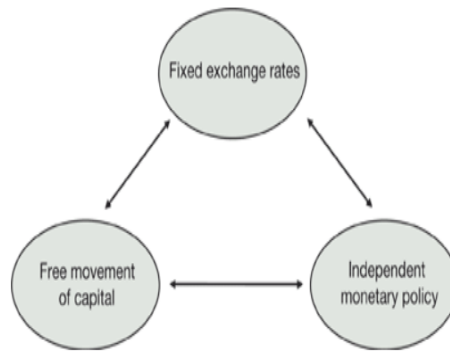


Figure 1: Impossible Trinity (Source: Beck and Prinz, 2012)

Following the breakdown of the Bretton Woods System in the 1970s, there has been a gradual but significant transition away from the previous system of fixed but changeable exchange rates. Until 1970, the concept of allowing the currency rate to fluctuate freely was rarely considered, save as a temporary solution during exceptional situations. However, by 1990, around 15 percent of all countries had transitioned to floating exchange rates. By 2006, the percentage of this share had increased to over 30 percentage. The shift away from fixed but flexible exchange rates was particularly noticeable in developed nations. By 2006, the use of intermediary arrangements had almost vanished, as monetary unification became the preferred approach in Europe, while other regions adopted floating exchange rates. In emerging nations, where the option of monetary unification was often not available, soft pegs did not disappear, but floating exchange rates became more popular (Eichengreen, 2008)

Dooley, Folkerts-Landau, and Garber (DFG) have put out the concept of a new economic system known as Bretton Woods II in a series of prominent articles. This system has gained popularity due to the rise of China and other Asian countries. Several nations are seen as significant participants in global markets, as evidenced by sources such as DFG (2005, 2007). DFG reports that China and other Asian countries have adopted an export-oriented approach, resembling the policy pursued by Japan in the years following the war. In order to maintain this approach, they may depend on a large number of unemployed individuals in rural areas. However, they must also attract Foreign Direct Investment (FDI) flows, which will provide them the required technology and managerial expertise to compete on a global scale.

The economic plan to maintain this process involves accumulating government reserves in the form of assets denominated in US dollars. The purpose of these reserves is to act as legitimate collateral, as foreign investors lack any other means of ensuring that the developing country

would neither default or nationalise the newly established enterprises. In order to build up these reserves, it is necessary to maintain a surplus in the current account, resulting in a positive net inflow of foreign money. In order to achieve this, developing nations should establish a fixed exchange rate for their currencies in relation to the U.S. dollar, set at a lower value than its actual worth. This should be supported by a surplus of total savings over total investments. In order to prevent the adoption of the monetary policy of the United States, certain nations may implement capital restrictions and neutralise the dollar inflows from their monetary bases, as a result of the Impossible Trinity concept. Something that is relatively simple in countries with significant government involvement, limited openness to imports, and undeveloped financial markets (Escrivá et al., 2008).

Against every suggestion and the only theory for the end of the BWII system Bibow (2010) suggested that instead a BWII regime's continuance after the 2008- 2009 crisis a new, BWIII system follows, once again, the current account deficits in the United States persist, but this time they are mostly caused by government expenditure and public debt. Unlike in BW2, the secure assets acquired by the official authority of the periphery would also serve as the actual assets supporting the excessive expenditure of the United States. Based on their sustainability research, it appears that BW3 has the potential to have a longer lifespan than BW2 and may also avoid a catastrophic failure. It is possible to imagine alternative scenarios in which the U.S. dollar would no longer have its special status as other important countries develop. Keynes's ideas from the 1940s could provide some guidance in this regard. However, without an official agreement, it may still take many decades for a post-dollar standard to emerge naturally (Bibow, 2010). His paper critiques Ben Bernanke's "*global saving glut hypothesis*" which states that over the past decade a combination of diverse 6 forces has created a significant increase in the global supply of saving—a global saving glut— which helps to explain both the increase in the U.S. current account deficit and the relatively low level of real long-term interest rates in the world today (Bernanke, 2005).

II.4. Theory of Bretton Woods III

The theory of Bretton Woods III contains different type of approaches that describe the current shifts in the world of economy.

Harold (2024) proposes a large-scale financial war that can shake the core of the current order saying that given that global financial stability is seen as a public benefit, several international institutions are dedicated to establishing the necessary circumstances for its preservation.

Nevertheless, geopolitical conflicts frequently provoke a shift in mindset, where instability abruptly becomes a valuable instrument for safeguarding one's interests in the context of global competitiveness. Under the current period characterised by trade conflicts, international supply chains, and limitations on the availability of crucial technology - referred to as "*geotechnopolitics*" - a fresh iteration of this longstanding phenomenon is unfolding. In the face of heightened global tensions following the covid-19 epidemic and the Russian incursion into Ukraine in 2022, there is a legitimate concern that the international order is deteriorating and that other concerns are overshadowing the pursuit of financial stability as a worldwide common interest. The formerly effective tactics in the zero-sum game are once again becoming significant, and the financial conflict has resurfaced again in the shape of sanctions. Indeed, it is inevitable that hostile financial speculation will eventually become a part of hybrid warfare, alongside cyber strikes and widespread disinformation. The circumstances for financial attacks are favourable (Harold, 2024)

Pilkington (2022) goes beyond that and suggested that the turning point for the dollar is the Russian-Ukrainian War and freezing Russian reserves. By blocking Russia's foreign reserves, the United States, the United Kingdom, and the European Union have indicated that other nations' ability to access their reserve assets in dollars, pounds, and euros depends on their foreign policy stance. This development will undoubtedly capture global attention, particularly in the context of China. China has consistently maintained significant trade surpluses with Western nations, resulting in the accumulation of substantial foreign reserves. However, the Chinese now need to consider these reserves from the perspective of their foreign policy. In the event that China was to take control of Taiwan, it is quite likely that the reserves would be subject to freezing (Pilkington, 2022). Dobozi (2024) agrees with these views stating that in order to accomplish its foreign policy objectives, the United States has progressively utilised the dollar as a weapon against geopolitical opponents. Iran, Venezuela, and Russia have been excluded from the SWIFT cross-border interbank payments system, which is controlled by the dollar. After Russia's incursion into Ukraine in 2022. The escalating geopolitical competition among the United States, China, and Russia has an impact on the value and influence of the dollar. China and Russia are actively pursuing a new global order that seeks to reduce the influence of the United States and weaken the role of the dollar. Russia has swiftly reduced its reliance on the US currency in its economy and instead shifted towards China's yuan (Dobozi, 2024). Pilkington (2022) even said that "*This action could mark a tectonic shift in the global monetary system comparable to the U.S. dollar breaking its peg to gold in 1971*".

In the following section a few important aspects will be introduced such as digital currencies like cryptocurrencies or central bank digital currencies.

Cryptocurrency is a form of currency that is encrypted, decentralised, and exists in a digital format. It may be exchanged between individuals, and the validity of transactions is verified by a process called mining, which involves maintaining a ledger. Cryptocurrency use cryptography to ensure its security. Cryptography, usually referred to as encryption, is a method employed to encode the protocols utilised in the cryptocurrency system. It serves as a safeguard against manipulation and deception, while also incorporating a mathematical mechanism for generating fresh units of money (Bhardwaj, 2017).

CBDC, or Central Bank Digital Currency, is a revolutionary monetary form that is produced electronically by the central bank with the purpose of being recognised as a valid means of payment. However, it would be distinct from other types of currency commonly issued by central banks, such as physical cash and reserve balances. A retail oriented CBDC would have broad accessibility. Evidently, CBDC is not designed to possess a tangible manifestation like to actual currency. However, if converted into currency, it would be easily obtainable by the population of a nation and perhaps by persons and organisations in other countries. CBDC has the potential to facilitate transactions of any value, whether they be between individuals, individuals and businesses, or between businesses. CBDCs may be implemented either as an account-based system or a token-based system. In the account-based system, the transfer involves moving a claim on an account, while in the token-based system, the transfer involves moving a token between wallets. A transaction in account based CBDC would be similar to current transactions between depositors in commercial banks, with the exception that the accounts would be maintained directly with the central bank. The central bank would guarantee the completion of a transaction by updating a primary record of financial transactions, but only after confirming the payer's authorization to use the account, the availability of enough cash, and the legitimacy of the payee's account (Peria et al, 2018).

Eichengreen (2022) evaluates the economic turmoil, and the adoption of digital currencies as follows. This transformation is likely to facilitate the broad adoption of cryptocurrencies, stablecoins, and central bank digital currencies. However, with further examination, it becomes evident that the future of various types of digital currency is uncertain and lacks certainty. Plain-vanilla cryptocurrencies clearly lack the fundamental characteristics of money, which include serving as a reliable store of value, universally acknowledged unit of account, and easy medium of exchange. The volatility of Bitcoin, exemplified by its fluctuating value, is evident to

everyone who has been tracking its price movements. The high level of volatility associated with this currency makes it less appealing as a standard unit for pricing goods and determining compensation. Payments via this method are inconvenient as they need the user to have a certain level of technological knowledge, a secure digital wallet, a password that can be easily remembered, and most importantly, a recipient who is willing to accept this kind of payment. Verifying transactions via Proof of Work, a method in which users of the distributed ledger solve complex mathematical problems, is widely known for its high energy and computer resource requirements. Bitcoin proponents assert that it should be included in investment portfolios, similar to gold, due to its lack of correlation with other asset classes, which makes it a unique investment option. However, this statement does not imply that it will be utilised as a kind of currency. Are returns on investing in gold reliable? Are digital currencies more than just a temporary trend? Gold is not convenient or appealing for use in transactions. Similar to how gold coins have lost their significance in payments, it is inevitable that Bitcoin and other cryptocurrencies of its like will also become irrelevant. Bitcoin appears to be primarily a specialised financial product rather than a widely used form of currency (Eichengreen, 2022).

III. Methodology

This study employs a qualitative research approach, underpinned by semi-structured interviews with esteemed monetary experts. Due to the exploratory nature of the research topic, which is the anticipated transition to a Bretton Woods III system and the potential decline in the dominance of the dollar, primary data collection was deemed necessary. The absence of existing literature on the nascent Bretton Woods III system granted an investigative method that could adapt to the emerging narrative and provide rich, insightful data. Therefore, the paper seeks to answer the following questions:

Is there a possibility for a new standard?

If the answer to this question is deemed positive, a subsequent question arises:

What are the feasible solutions?

The primary data was collected through in-depth interviews with six monetary experts, including notable figures like Zoltán Pozsár (Senior Advisor at the U.S Department of the Treasury 2012-2015), Júlia Király (Vice President of Hungarian National Bank 2007-2013), Ákos Péter Bod (first President of the Independent Hungarian National Bank 1991-1994), and István Magas (Emeritus at the Department of World Economy at Corvinus University of Budapest), as well as two anonymous experts who did not want their names and positions to be shown mainly because of the Hungarian monetary turmoil.

Given the novelty of the subject matter, the scope of the research was initially defined through a series of exploratory discussions. This allowed for an open-ended approach, enabling the respondents to discuss the intricacies of international monetary systems, the historical precedents of currency transitions, and the role digital currencies may play in the future. The questions consisted of the following: “*Are we in the BW3 system?*”; “*What are the roles of crypto currencies?*”; “*What other currencies can take the dollar’s role?*”; “*Are we heading towards a single currency system or a multipolar one?*”; “*What are the role of economic alliances?*”; “*What event can facilitate a new monetary system’s emergence?*”.

The analysis entailed a thorough examination of the interview transcripts, with a focus on recurring themes and unique insights. This qualitative data was then triangulated with secondary sources, including academic papers closely related to the subject matter and empirical evidence reflecting the current economic landscape.

The methodology employed in this research allows for an in-depth exploration of the speculated dethronement of the dollar, through the insights of leading experts and a rigorous analysis of current trends and historical patterns.

IV. Findings

IV.1. Bretton Woods I and The Failure of the Gold Standard

The Bretton Woods Agreement (BW), established in 1944, guided the world into a new era of international economic order. The agreement solidified the US dollar's position as the global reserve currency, backed by the immense US gold reserves and its dominance in international trade settlements. The BW system functioned through a fixed exchange rate regime where major currencies were pegged to the dollar, which in turn, was convertible to gold at a fixed rate of \$35 per ounce. This convertibility feature, along with foreign exchange reserves, served as the two pillars of the system. The BW system, particularly during its initial phase (BWI), demanded fiscal discipline. The convertibility of US treasuries into gold constrained the US government from running excessive budget deficits. However, by the 1960s, this pillar began to erode. Rising public spending fuelled by welfare programs, the Vietnam War, and other Cold War expenses led to significant debt accumulation. The US government resorted to debt monetization by the Federal Reserve, further straining the gold peg's credibility.



Figure 2: Government Current Expenditures/Gross Domestic Product (Source: Federal Reserve Bank of St. Louis, 2024)

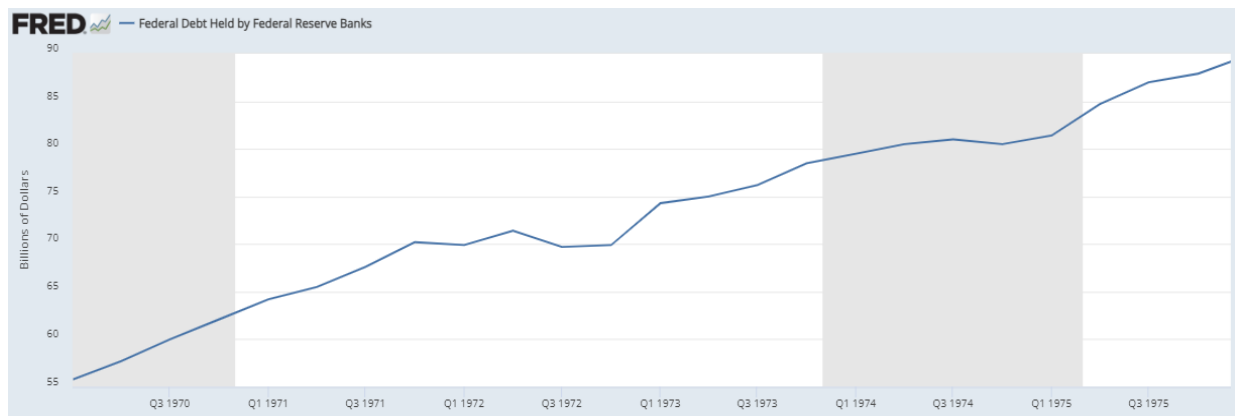


Figure 3: Federal Debt Held by Federal Reserve Banks (Source: Federal Reserve Bank of St. Louis, 2024)

The amount of federal debt held by federal reserve banks also had to grow significantly over the same period, from about \$55.800billion in 1970 to \$87.900 billion in 1975, to fund these outlays as seen in Figure 3 and the proportion of government spending relative to GDP increased from around 18,3% in 1965 to nearly 24% in 1975, as seen in Figure 2.

Concern was inevitable for central banks which were holding a substantial amount of U.S debt, since the value of the dollar in relation to gold was in jeopardy. The amount of U.S government debt exceeded the gold supply, because of that many central banks started to convert their treasuries into gold, France leading the pack. This process convinced President Nixon to abandon the gold standard in 1971, collapsing the first Bretton Woods system.

The first thing we can observe is that how important “trust” is in an intertwining system like that, France started the dominos, but everyone followed, and it crushed the gold peg. Secondly, in my opinion a gold peg’s biggest weakness is its rigidity. It limits the ability of central banks to intervene in case of a recession which might push countries into a longer downturn opposed to a swift intervention. Many prominent economists oppose the reintroduction of the gold standard such as Ben Bernanke (2012) who said: *"Since the gold standard determines the money supply, there is not much scope for the central bank to use monetary policy to stabilize the economy"*. During economic downturns and wartime gold tend to do better on the market but as a standard it tends to fail in these times. Because of this and the aforementioned reasons the gold cannot be a feasible solution for a new standard.

IV.2. Utilizing Dollar Dominance in the Current BWII System

As the Bretton Woods II system is basically a theory or the unofficial name of the monetary world order that followed the BWI system, it is important to observe its implications.

The abandonment of the dollar-gold parity and fixed exchange rate system in 1971 resulted in a reduced need to maintain foreign exchange reserves by nations that had previously held prominent positions in the Bretton Woods system, including France, the United Kingdom, and Italy. However, under the Bretton Woods II system, the dollar-franc exchange rate would vary freely in response to shifts in global capital movements. This clearly shows that the need to find an additional source of support for the dollar's status as a reserve currency was rising, since it cannot only rely on European central banks' foreign exchange reserves. Nevertheless, the BWII system has gained significant traction, particularly in emerging economies. Economies like Brazil, India, and China witnessed significant growth, and these countries accumulated foreign exchange reserves for various reasons. A crucial driver was the need to recycle current account surpluses into a stable reserve currency. The US dollar, post-Volcker disinflation, emerged as the preferred choice (Goodfriend and King, 2005). This can be explained by the Federal Reserve's commitment and fight for price stability.

After BWI the U.S ended up with historic trade and current account imbalances due to government spending increasing limitlessly after the Nixon shock. This direction also increased budget deficits and public debt. The private sector was promptly impacted by the implementation of expansionary fiscal policies, which led to an increase in personal spending and a decrease in personal savings rates. According to George Schultz (2019), a former US Secretary of State and economist, in order to balance its production and consumption, a nation must import in excess of its exports. That is mathematical not a rip-off but rather appropriate. The culprit is federal deficit spending, an enormous and ongoing act of dissaving. Manage that expenditure to exert control over trade deficits.

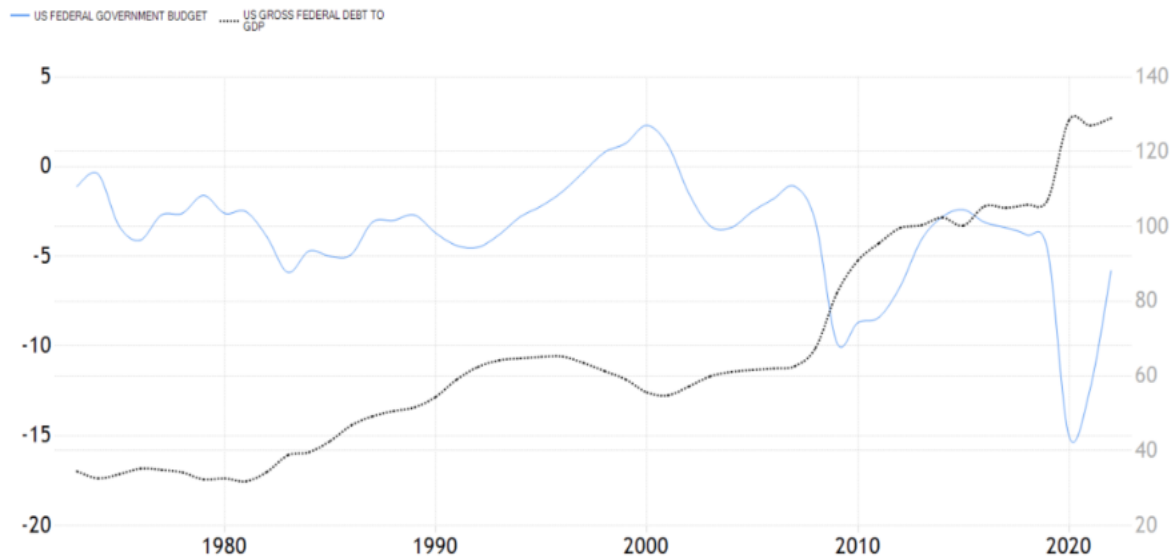


Figure 4: Comparison of U.S Government Budget and Debt to GDP Ratio (Source: Trading Economics, 2024)



Figure 5: Comparison of U.S Current Account and Balance of Trade (Source: Trading Economics, 2024)

These two figures depict the trajectory of the United States' macroeconomic approach during that time. Substantial deficits in both the trade and current account, induced by the heightened budget deficits resulted in increased levels of public debt.

If the United States of America has a current account deficit or trade deficit with another nation, money flows from the United States to the foreign nation, while products or services are sent from the foreign nation to the United States. According to a FED report, in 1965, there were

just 13 American banks that had foreign operations; by 1980, that number had expanded to nearly 800 and combined branch assets exceeded \$340billion from the initial \$10billion in 1965 (Haupt et al, 1999). This demonstrates the dollarization of the world that occurred in the BWII era. In an interview Joseph Stiglitz said that global demand for dollars has supplanted demand for manufactured goods and services, resulting in multilateral trade deficits and loss of jobs at home (Gardels, 2009).

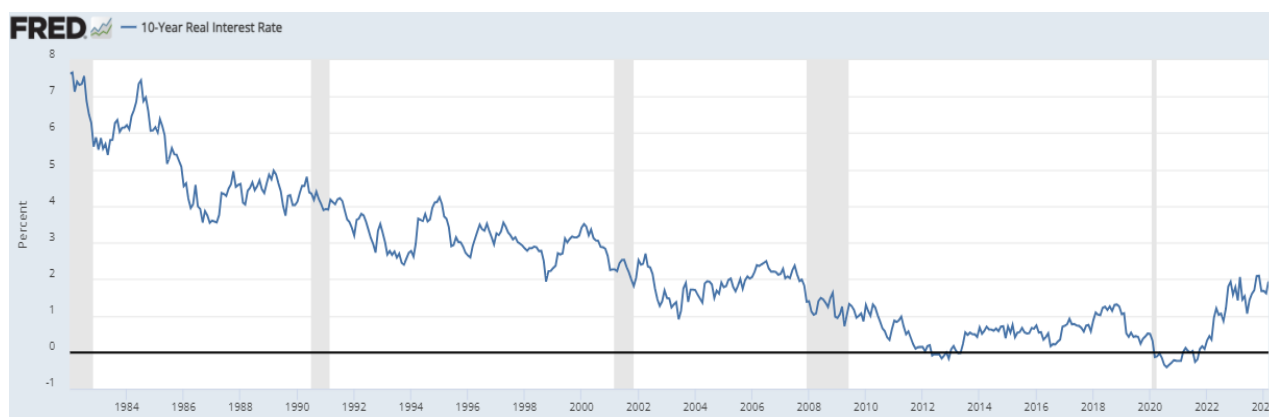


Figure 6: 10-year Real Interest Rate (Source: Federal Reserve Bank of St. Louis, 2024)

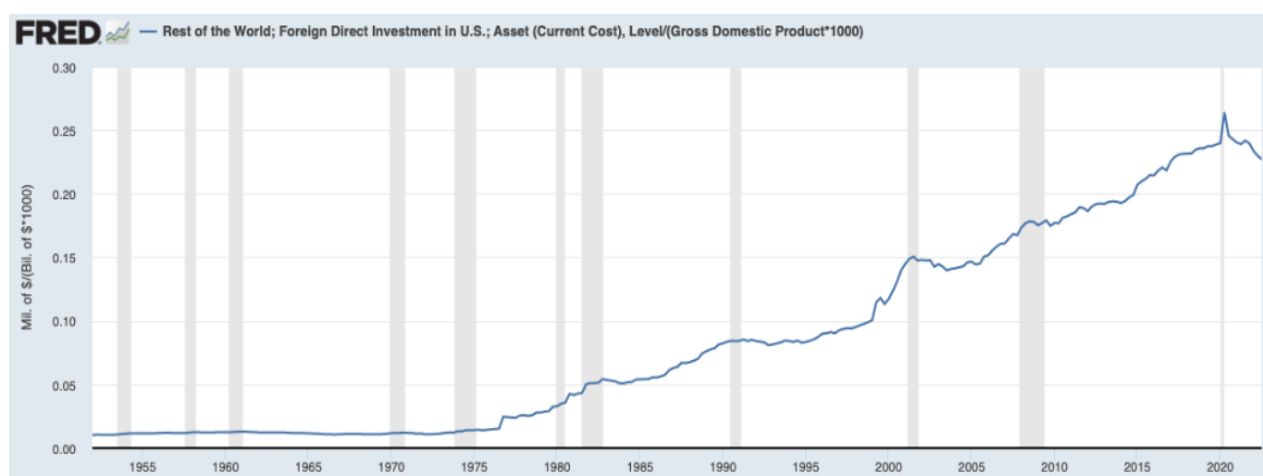


Figure 7: Foreign Direct Investments in the U.S./U.S GDP (Source: Federal Reserve Bank of St. Louis, 2024)

Figure 7 shows a substantial flow of foreign funds into the United States. This is evident from the rise in the ratio of foreign direct investment to GDP, which has grown from about 0% in 1971 to over 26% in 2020. Additionally, the demand for dollars has led to a systematic reduction in the real interest rates in the United States, as seen in the first chart.

The status quo of Bretton Woods II can be summarised as follows: (1) there has been a consistent and systemic demand for United States Treasury securities over the course of the past half-century, which has resulted in a reduction of real interest rates year after year and enabled the United States to run constant budget deficits and make a use of the enormous power the dollar holds; (2) the demand originated from foreign central banks, The goal was to collect earnings from current account surpluses in more secure currencies; (3) inflation was controlled in the United States as a result of the demand for dollars by other nations and their exportation overseas in exchange for low-priced goods and services. Deflation, rather than inflation, was always the primary concern of central banks; (4) The dollar is/was the single most dominant currency in the world.

IV.3. Views for a BWIII System

IV.3.1. Commodity Based View

“We are witnessing the birth of Bretton Woods III – a new world (monetary) order centred around commodity-based currencies in the East that will likely weaken the Eurodollar system and also contribute to inflationary forces in the West. A crisis is unfolding. A crisis of commodities. Commodities are collateral, and collateral is money, and this crisis is about the rising allure of outside money over inside money. Bretton Woods II was built on inside money, and its foundations crumbled a week ago when the G7 seized Russia’s FX reserves” (Pozsár, 2022).

Pozsár (2022) identifies the People’s Bank of China (PBoC) as the only influential player in the market and proposes two options for them: The PBoC has two geo-strategic or geo-financial options, sell treasuries to fund the leasing and filling of vessels to clean up subprime Russian commodities. That would hurt long-term Treasury yields and stabilize the commodities basis and would give the PBoC control over inflation in China, while the West would suffer commodity shortages, a recession, and higher yields or to do its own version of QE – printing renminbi to buy Russian commodities. If so, that’s the birth of the Eurorenminbi market and China’s first real step to break the hegemony of the Eurodollar market. That is also inflationary for the West and means less demand for long-term Treasuries (Pozsár, 2022).

At the end he proposes two very interesting aspects, first the renminbi will get substantially stronger meanwhile the dollar gets weaker. Second cryptocurrencies especially bitcoin will become laughing thirds (Pozsár, 2022).

The main convictions of his papers are the following, commodities are getting a more important role especially regarding China, the renminbi gets substantially stronger next to the weakening dollar and lastly, he mentions bitcoin as well. Also, a very important aspect for me is that he mentioned the weaponization of the dollar and how that results in loosing trust in the currency which could be a huge blow for it.

During my discussion with Zoltán Pozsár, he made some revaluations about his approach in the matter. He still emphasized the importance of commodities such as the gold as a reserve but not as a standard. The most important aspect regarding commodities is international trade, there are more and more countries who buy and sell commodities in their own currency such a country is China. For example, oil is one of the most important commodities and China has the ability to acquire it from Saudi Arabia in their own currency. The Saudis instead of putting the received renminbi in fixed income securities they use it for their capital investments since China can provide all the necessary tools (Pozsár, 2024).

IV.3.2. Crypto Based View

Cryptocurrencies especially Bitcoin came up so many times during my interviews and my research it is inevitable to include it in this paper.

“COVID pandemic and resulting challenges to the financial system has led El Salvador to introduce bitcoin as a legal tender, which was followed by the Central African Republic. The Central African Republic has made bitcoin a legal tender and reserve currency in April 2022 in addition to the CFA Franc” (Katterbauer et al, 2020).

As an important turning point for the world's largest cryptocurrency and the cryptocurrency sector as a whole, the United States Securities and Exchange Commission (SEC) gave its approval on Wednesday to the first exchange traded funds (ETFs) that are listed in the United States and that track bitcoin. The SEC has announced that it has granted approval to eleven applications. These applications include those from BlackRock (BLK.N), Ark Investments/21Shares (ABTC.S), Fidelity, Invesco (IVZ.N), and VanEck. This approval comes even though certain officials and investor advocates have cautioned that the products in question are associated with potential risks. ETFs, which have been in the works for a decade, are a game-changer for bitcoin because they provide investors with exposure to the largest cryptocurrency in the world without requiring them to actually possess bitcoin. They provide a significant boost to a cryptocurrency sector that has been plagued by scandals. *"It's a huge*

positive for the institutionalization of bitcoin as an asset class," said Andrew Bond, managing director and senior fintech analyst at Rosenblatt Securities (Reuters, 2024).

It is evident that despite the aforementioned scandals crypto is going a long way especially Bitcoin. But is it enough to be a significant player in the world of currencies?

From all the aspects that surfaced during the research this is the easiest to dismiss. Especially in 2024 it gained a lot of ground especially in connection with investments and capital markets, the first bitcoin ETFs had been introduced. In March it even overtook its previous record it achieved the price of \$72,720.

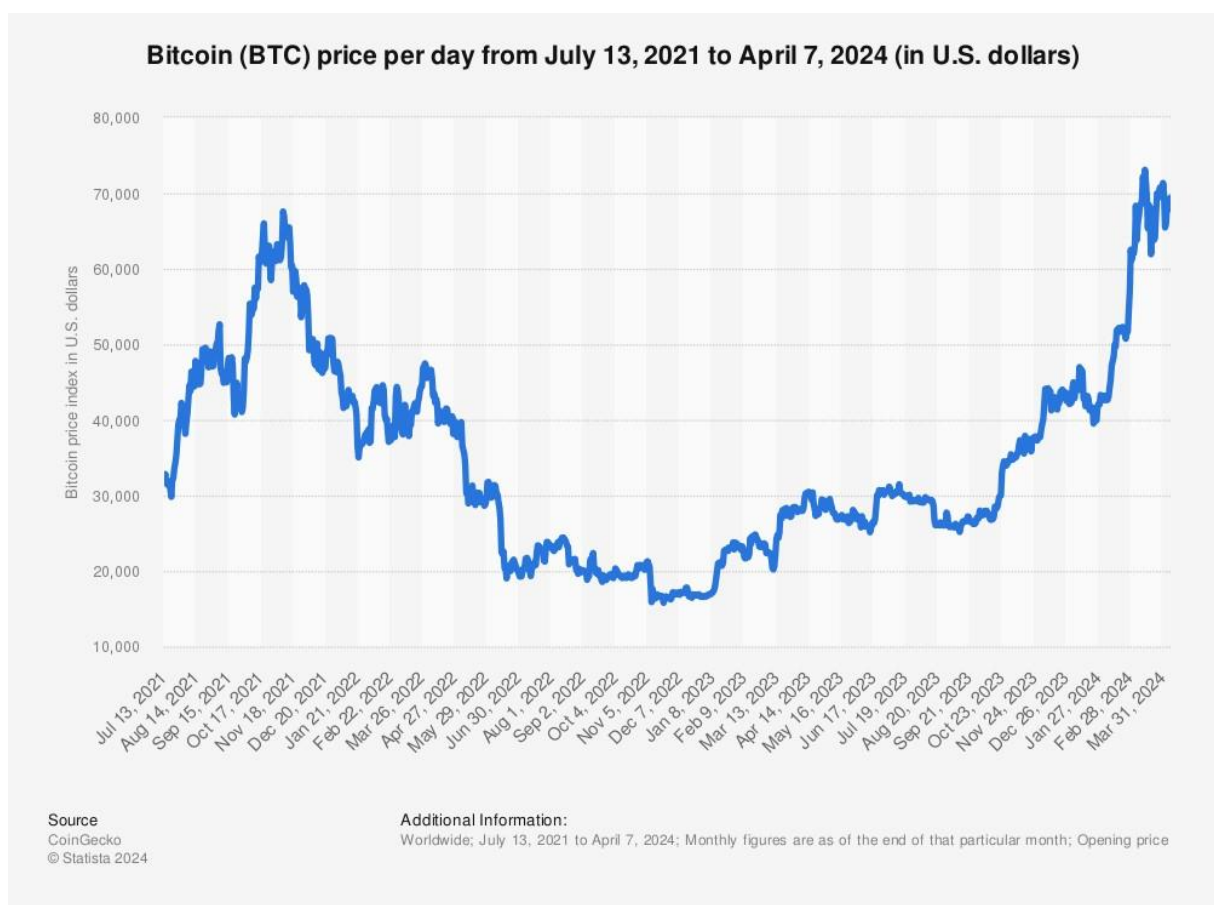


Figure 8: Bitcoin Price per Day from July 12 2021 to April 7 2024 (Source: Statista, 2024)

The figure shows that bitcoin lives it's second peak but if we look at Bitcoin's history there is a huge fluctuation regarding its price exceeding more than 300%.

As stated before Bitcoin had been introduced as a national currency in El Salvador and in the Central African Republic. Júlia Király (2024) only commented this with saying *"It's a minor experiment in minor countries without important lessons, they are not good examples of the*

future monetary system” and I have to give that to her, Bitcoin is in such its infancy, it is incapable of being a dominant figure in such a big picture.

IV.3.3. CBDC Based View

Due to the fact that they were able to execute hundreds of thousands of transactions per second, it can be deduced that the CBDC system would be able to manage the number of transactions that are typical in the economy. Additionally, it seemed as though the majority of the transactions were scalable because to the researchers' deployment of more recent servers. We may begin to consider a new version of Moore's Law, which explains the performance of microchips. Instead of calling it Moore's Law, we might call it Hamilton's Law since it has been utilised in the development of chips because of its application. The publication of the components of the system that are associated with user interface and confidentiality will mark the completion of the second phase of the Hamilton project. The benefits of CBDC will be convincing to all parties involved, including consumers, corporations, central banks, and governments, if both of these aspects are successfully addressed. In the end, as Professor Bohme pointed out in the MIT-Fed initiative, individuals will not lose their money as a result of the many frauds that are currently concerning cryptocurrencies. There will be a shift in the rules of the game in the world of finance as soon as one of the primary dangers associated with cryptocurrencies is eradicated and the advantages are preserved (Matolcsy, 2022).

As of the end of the year 2022, China has conducted large-scale testing of the central bank digital currency (CBDC) in 26 different regions spanning 17 different provinces. However, the sites where it may be utilised are still restricted. At the end of December 2022, there were only 13.6 billion yuan (\$1.86 billion) in circulation, which was barely 0.1% of the entire supply of yuan. This was despite the fact that the digital yuan was introduced with a great deal of hoopla. The CBDC is not something that many people are willing to go out of their way to utilise because there are existing digital payment systems in the private sector that are widely used, such as Alipay and WeChat Pay. As part of an effort to broaden the usage of the currency, the Chinese government entered into partnerships with Alipay in December and WeChat Pay in March. These partnerships made it possible for the digital yuan to be utilised on the two most prominent payment systems in the nation. Despite the fact that the currency was first established with the intention of reducing the market dominance of those services, it is quite probable that it will take some time before it is able to achieve this objective (Sekiguchi and Lejun, 2023).

Eichengreen (2022) stated that *“Countries like China see issuing a CBDC as a way to enhance the international attractions of their currencies and diminish the dominance of the dollar”*.

It can be observed that there are numerous countries experimenting with this approach. Especially China which can be considered a pioneer in this research. During our interview Júlia Király (2024) stated that *“Digital central bank currencies will appear soon and smooth the international paying system”*. CBDCs cannot be seen as a negligible attempt to make a difference.

Central Bank Digital Currencies have prominent prospects in the world economy. Many countries find CBDCs very promising, for China it might be the tool to take down the dollar's dominance. Júlia Király (2024) even said that *“The appearance of CBDCs will end the current BWII system”*, she spoke very highly of CBDC during the entirety of our discussion. Zoltán Pozsár (2024) added that the East especially China has a great direction regarding CBDCs in the context of cross-border trade, they want to create a foreign exchange market where there is a significant liquidity between less used currency pairs.

On the other hand, Central Bank Digital Currencies need some time to be fully operational. *“Issuing a CBDC isn't the end of the process -- there needs to be a framework to evolve it over five to 10 years,”* said Masashi Nakajima, a professor of economics at Japan's Reitaku University (Sekiguchi and Lejun, 2023). Not only a framework is needed but many sources agree that it still needs technical developments to be fully functional, also after the implementation of every aspect as all new approaches it should gain the trust of its users. Experts do not have a definitive answer for its proper introduction to the monetary system, but many suggests around 10 years. This in fact can be a frightening tool for the dethronement of the dollar, even so because it is within a reachable timeframe!

IV.3.4. China's ambitions

China is the number one competitor in regards of taking over the dollar dominance, they extended their efforts in numerous directions. In this section this paper is looking into the current state of China's ambitions.

One of the main initiatives of China is the so called One Belt One Road initiative (OBOR) or sometimes called as the New Silk Road. Established in 2013 by President Xi Jinping, the extensive collection of development and investment programmes was first designed to connect East Asia and Europe through tangible infrastructure. Over the past ten years, the initiative has extended its reach to Africa, Oceania, and Latin America, thereby greatly enhancing China's

economic and political sway. Xi's vision included the establishment of an extensive infrastructure system consisting of trains, energy pipelines, highways, and efficient border crossings. This network would span both westward, across the mountainous regions of the former Soviet republics, and southward, connecting Pakistan, India, and the rest of Southeast Asia. This network would facilitate the global adoption of the Chinese currency, the renminbi. (McBride, Berman and Chatzky, 2023). This initiative is quite remarkable in terms of facilitating trade but also in infiltrating new markets and strengthening the power of China.

The other main initiative of China is to gain economic alliances and new markets. BRICS was founded in 2009 by Brazil, Russia, India and China. Since then, several other members joined the alliance such as the Republic of South Africa, Iran, Egypt and the United Arab Emirates. But István Magas (2024) emphasised that for a country's currency to take a leading role economic power is not enough, it needs military and political power as well.

China's efforts had been fuelled after the sanctions and the seizing of reserves of Russia. It basically meant that the West is weaponizing the dollar which urged China to accelerate its goals to establish Renminbi as a stronger and more prominent currency meanwhile trying to lower the dollar's influence. *"There's a need to build a financial network which is not controlled by Western Powers"* (Pozsár, 2024).

Russia, which is responsible for almost ten per cent of the world's oil output, is the most notable nation that has moved its sales away from purchasing dollars. The sanctions that were imposed on Russia as a result of its invasion of Ukraine have resulted in the cessation of oil exports to Europe and the United States. Instead, a growing quantity of Russian oil has been exported to India and China. A number of other nations that have been subjected to sanctions by the United States have also changed the currencies that they use. Following the implementation of sanctions by the United States, Venezuela, which possesses the greatest oil reserves in the world, began trading its oil using either the Chinese yuan or the euro when conducting business. A total of around twenty percent of the world's oil supply is currently being sold at reduced prices as a result of sanctions. A significant portion of that trade has gone away from the dollar, or at the very least has the potential to go away from it (Salzman, 2023).

Additionally, Russia were excluded from the dollar-dominated SWIFT cross-border interbank payments system, Washington has prohibited American banks to do business with Russian entities and frozen assets held in the U.S. by the central bank of Russia. As of mid-2021, fully 40 percent of cross-border payments cleared by the Society for World-wide Interbank Financial

Telecommunication (SWIFT, the international equivalent of Fedwire, which is owned and operated by its member financial institutions) were transfers of dollars. This is despite the fact that the United States accounts for just one-seventh of global GDP in purchasing power parity, or price-adjusted, terms. In contrast, transfers of China’s currency, the renminbi, accounted for less than 2% of cross border payments. According to Statista this number increased to 3,12% by January 2024. Meanwhile the dollar nearly reached the 60% mark.

During my discussion with Zoltán Pozsár (2024), he drew my attention to the fact that it is true that the US and the dollar dominates SWIFT, but China developed its own payment system called CIPS (Cross-Border Interbank Payment System). *“CIPS clears and settles Chinese renminbi transactions, with other financial market infrastructures, drawing lessons from how those entities have thrived or failed, the market-maker in the adjacent trading market is the Chinese government, a sovereign state that wields a monopoly over the renminbi”* (Chang, 2023). It is hard to access the state of Renminbi because of that since there’s little to no information about the quantity and volume of cross border trade conducted on the platform. Furthermore, the data that is accessible, content wise it is highly questionable.

A currency’s role and power can also be measured by looking at other countries’ FX reserves. It shows the importance of the currency and also the trust that is shown towards it.

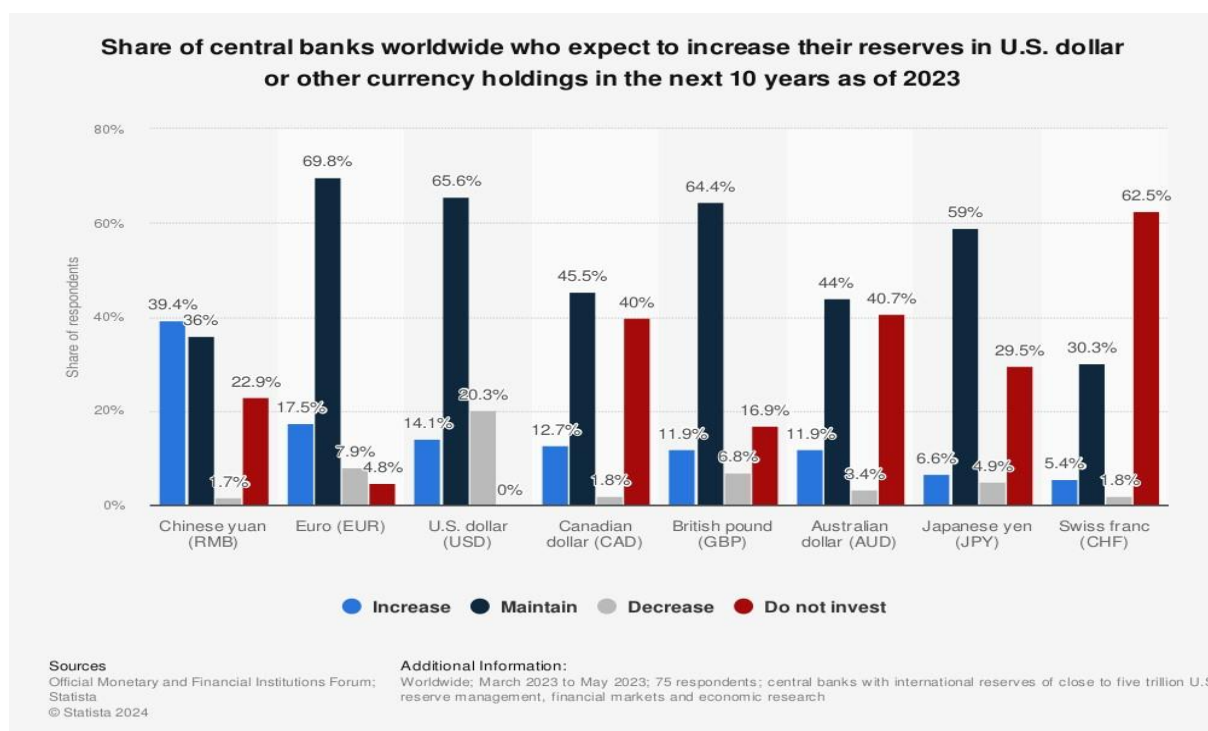


Figure 9: Share of central banks worldwide who expect to increase their reserves in U.S. dollar or other currency holdings in the next 10 years as of 2023 (Source: Statista, 2024)

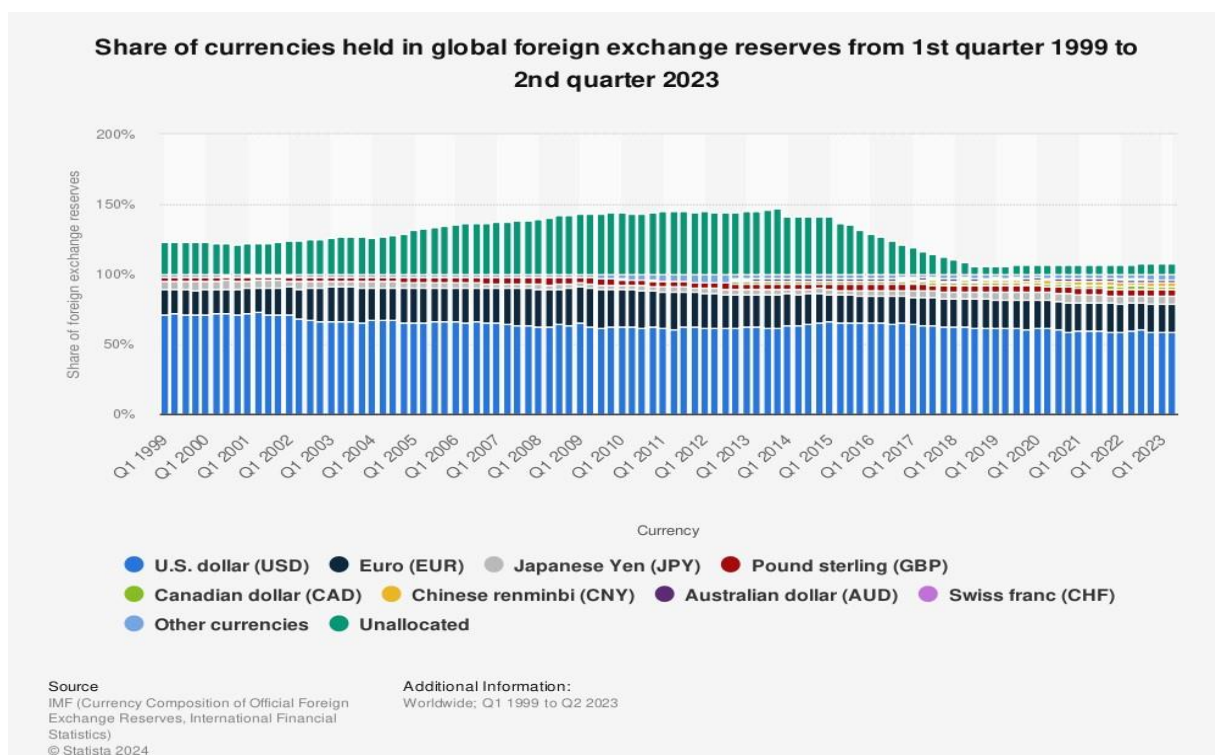


Figure 10: Share of currencies held in global foreign exchange reserves from 1st quarter 1999 to 2nd quarter 2023 (Source: Statista, 2024)

The figure above shows the trends towards expanding Renminbi reserves, it can be seen that it is the highest increasing currency among the shown “competitors”. On the figure below the harsh reality hits us that despite all the increasing trends the renminbi is only the sixth in terms of size with 2,45% of total reserves.

We can observe increasing trends in strengthening the renminbi, but it is still far away from stealing the number one spot. The world is more inclined towards a multipolar world where the renminbi and China can play a very important role. During my discussions with István Magas (2024) he said, “For the Renminbi to get strong enough it needs at least half a generation”. Júlia Király (2024) commented it with “Not in my lifetime”.

IV.3.5. Remarks on the Euro

The euro is an important player in the world economy, so how come in this paper it never came up as a potential successor? It is the second biggest foreign exchange reserve when it comes to volume and it dominates European trade but EU weaponized the euro just as much as the U.S did with the dollar, so the same convictions can be drawn as well. During my interviews none of interviewees deemed it a feasible solution for a new standard because of the aforementioned

reasons. Also, there is some literature that explains the reasons. “There is an inadequate supply of high-quality euro-denominated assets that international investors and central banks can use as a store of value, and no eurozone-wide “safe” government-backed asset. The share of euro-denominated central bank reserves remains slightly over 20 percent, roughly the same as at its introduction. Its use in foreign exchange transactions, as measured by the Bank for International Settlements’ worldwide survey of the largest currency dealers, has also held roughly constant, at around 35 percent” (Ilzetzki et al, 2021)

IV.3.6. The Power of the Dollar

To clearly assess the situation, it is inevitable to observe the current position of the dollar.

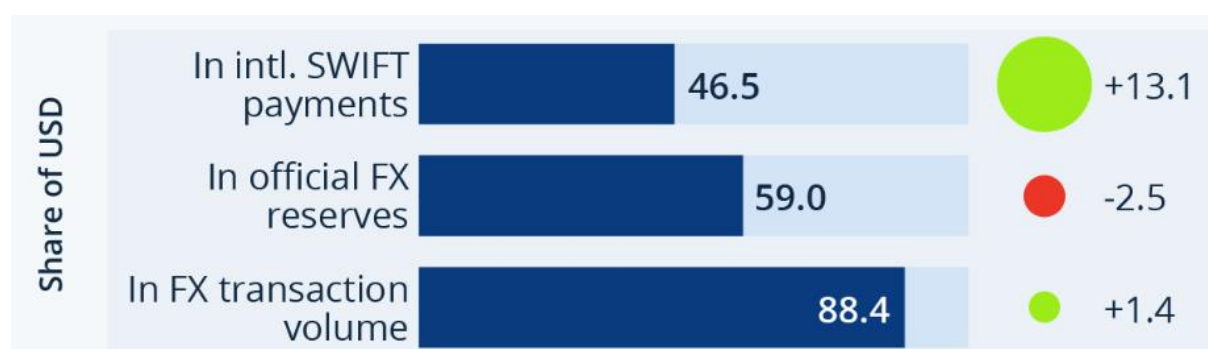


Figure 11: Dollar in the global economy and global financial transaction (in %) between 2012 and 2023 (Source: Statista, 2023)

This figures clearly shows the tremendous power the dollar holds in terms of global trade. The dollar still dominates international transactions. In the chart we can see that the dollar is responsible for 46,5% of international SWIFT payments but as of January 2024 all payments going through SWIFT the dollar is responsible for nearly 60% of all payments (Statista, 2024). As mentioned earlier 58,88% of all FX reserves are held in dollar.

Decreasing trends can be observed but still we are long way apart from a new dominant currency. In that there’s little dispute between experts and scholars, Júlia Király (2024) said that “The dollar is still the leading currency and I’m sure that because of the overwhelming strength of the US economy it will be the definitive currency in the coming decades”, Ákos Péter Bod (2024) adds to this by saying “Globalisation has entered a new phase, the U.S. is starting to take up a defensive position because of its own vulnerability, but just because something is working sub-optimally doesn't mean it will fall apart, for example, it was already apparent in 1960 that the Soviet Union was falling apart, but it survived until 1990”. However, Zoltán Pozsár (2024) foreshadows that “There are financing problems in the United States, without

the help of the Federal Reserve, the system wouldn't be able to swallow all the paper it has issued, so sometime this year QE will certainly start again”.

V. Conclusions

V.1. Summary of the Findings

This research paper has sought to explore the evolving dynamics of the global monetary and economic system, questioning the longevity of the U.S. dollar's dominance and evaluating potential shifts toward a new international currency standard. The analysis reveals that multiple forces—economic, technological, and geopolitical—are converging to challenge the existing dollar-centric order, suggesting the emergence of alternatives that could redefine global financial stability and economic interactions. The current Bretton Woods II system, characterized by the unipolar dominance of the U.S. dollar, faces significant scrutiny due to its inherent limitations in addressing global economic imbalances and the geopolitical weaponization of the dollar. The prospect of a new currency standard depends on global economic shifts and the roles that emerging market currencies might play in the future financial landscape. The analysis suggests that while a single global currency standard replacing the dollar is unlikely in the near term, there are several feasible alternatives that could collectively form a more decentralized and stable system.

The Euro, despite its significant role within the European Union, does not currently pose a direct challenge to the dollar's status due to similar challenges of political cohesion and economic stability for the same reasons as the U.S. itself. Instead, the Chinese Renminbi emerges as a significant contender in the discourse on potential alternatives to the dollar. China's strategic manoeuvres in international finance, such as the expansion of the Belt and Road Initiative and efforts to internationalize the Renminbi, coupled with its robust economic growth, position it as an inevitable player in the potential reshaping of the global monetary landscape. However, the full realization of the Renminbi as a dominant global currency is contingent upon broader international acceptance and the overcoming of significant political and economic hurdles.

Bitcoin's integration into the global financial system represents a significant change in the potential for a digital currency to influence or partially supplant traditional currencies. As countries like El Salvador begin to adopt Bitcoin as legal tender, and major financial institutions integrate cryptocurrency into their operations, the potential of crypto currencies increase but in a global monetary sense they are not considered a viable option since Bitcoin's role is currently

more similar to that of a digital asset rather than a currency per se, due to its volatility and limited use in everyday transactions.

The development of Central Bank Digital Currencies (CBDCs) also highlights the growing intersection between digital innovation and monetary policy. CBDCs, such as the digital renminbi, are designed to offer the benefits of digital currencies while being backed by and regulated through national central banks. This hybrid approach could provide a more stable and internationally accepted digital currency model that might be integrated into the global financial system alongside, or in place of, traditional currencies. On the other hand, it still needs time to be integrated into our everyday life.

Up until today these important shifts were preceded by certain catalysts. BWI was a result of the second World War, BWII happened because of the Nixon shock. Many scholars and experts both in my research of appropriate literature and in my interviews agree that today the catalyst may well be the Russian-Ukrainian war. It did not immediately result in a new order but accelerated the movements of nations on the playing field.

In conclusion, the potential for a new monetary standard to emerge as a viable alternative to the U.S. dollar involves a complex interplay of economic strength, technological innovation, and geopolitical strategy. While the dollar will likely maintain a significant role in the immediate future, the evolving landscape of global economy suggests a gradual shift towards a more polycentric monetary order.

V.2. Limitations

The research acknowledges several limitations inherent in qualitative studies, which predominantly stem from the subjective interpretation of data and the variability in expert opinions. This methodological approach, while providing in-depth insights and nuanced understanding, might not capture the full spectrum of global economic dynamics or the quantitative scale of economic shifts. Furthermore, the rapidly changing economic conditions and ongoing developments in international finance policy discussions, especially those surrounding the conceptualization of a Bretton Woods III framework, suggest that the findings presented here represent only a snapshot in time. This study opens the door for further research, particularly in the areas of digital currency adoption and the dynamic responses of global economies to shifts in monetary policy and currency standards.

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