

The Exorbitant Construction: Petrodollars, Statecraft, and the Myth of Dollar Necessity

09 May 2026

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Abstract

The dollar's position as the world's primary reserve currency has, since 1971, been accompanied by persistent American current account deficits and a financialized domestic economy. Much of the existing literature treats these features as structural requirements of reserve currency issuance. This paper argues that dominant framings have given insufficient attention to a specific set of material arrangements: the bilateral understandings negotiated between the United States and Saudi Arabia in 1974, whose financial terms remained confidential until 2016, and through which Saudi petrodollar surpluses were placed in US Treasury securities within a wider package of security, arms and development cooperation. The popular post-1971 reading of the Triffin dilemma holds that persistent current account deficits are structurally necessary. They are not. The petrodollar order inverts the conventional causal story: the exorbitant privilege was not earned through economic performance but secured through statecraft.

Keywords: global reserve currency, petrodollar recycling, dollar hegemony, negotiated currency, financialization, Triffin dilemma, statecraft

JEL Codes: F31, F32, F33

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1. Introduction

The share of the US dollar in global foreign exchange reserves has fallen from roughly 73 percent at the turn of the millennium to around 56 percent in 2025. Figure 1 makes this trajectory visible directly.

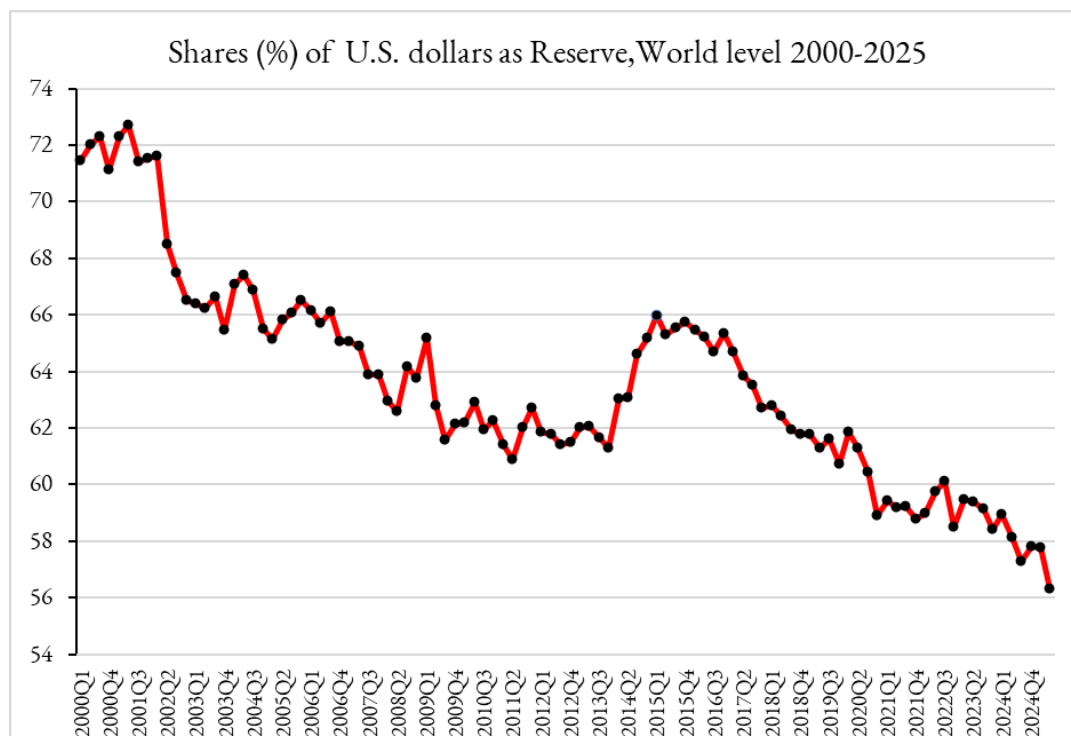


Figure 1. Shares (%) of U.S. dollars as Reserve, World level 2000-2025

Source: Bibi (2026) based on IMF-International Financial Statistics ([IMF, 2024](#))

The headline figure understates the depth of the shift. Russia and China now settle the great majority of their bilateral trade in their own currencies. The mBridge platform, a multilateral cross-border central bank digital currency project linking the central banks of China, Hong Kong, Thailand and the United Arab Emirates, reached its minimum viable product stage in 2024. In June of the same year the Saudi Central Bank joined it as a full participant. In October 2024 the Bank for International Settlements withdrew from the project, which is now run by the participating central banks. [Arslanalp et al. \(2022\)](#) describe the overall pattern as the stealth erosion of dollar dominance, driven not by a single challenger but by gradual diversification across many actors. Whether anything coherent replaces the dollar as the primary global reserve currency has moved from academic speculation to practical policy concern. China is the most discussed candidate. Since 2014 it has surpassed the United States in GDP at purchasing power parity and is the world's largest trading nation. Its leadership has meanwhile pursued renminbi internationalization through bilateral swap lines, the Cross-border Interbank Payment System (CIPS), and the digital yuan ([Taylor, 2025](#)). Yet the renminbi accounts for less than 3 percent of global payments and less than 3 percent of officially reported foreign exchange reserves ([IMF, 2025](#); [SWIFT, 2026](#)).

Two bodies of scholarship have shaped how this question is typically approached. The first, rooted in mainstream economics and conventional international political economy, treats reserve currency status as

resting on identifiable structural prerequisites: capital account openness, deep and liquid financial markets, and a willingness to run persistent current account deficits to supply the world with the reserve asset it needs. Prasad and Ye (2012) make this case explicitly, and the same reasoning runs through the broader empirical literature on reserve currency determinants (Prasad, 2021; Lardy & Douglass, 2012; Yu, 2014; Genberg, 2009; Mussa et al., 1998; Eichengreen and Kawai, 2014). On this account, dollar dominance reflects underlying American economic power, and its gradual erosion tracks the relative decline of that power. The second, influenced by the social studies of finance and post-structuralist political economy, has moved in a different direction. Rather than grounding monetary hegemony in economic fundamentals, this literature emphasises the performative and self-reinforcing dynamics through which dollar dominance is reproduced. These include the iterative practices of financial intermediaries, the market conventions that lock in dollar invoicing, and the institutional microstructures that perpetuate reserve currency status independently of any underlying material logic (MacKenzie, 2006; Langley, 2008; Bryan and Rafferty, 2006). The insight that dollar dominance cannot simply be read off from trade flows or industrial structure is one this paper shares.

What neither tradition has placed at the centre of its enquiry, although for different reasons, is the question of how the material and geopolitical anchors of the dollar system were originally constructed. These arrangements are constitutive of the system rather than background to it. The bilateral arrangements that organised the recycling of petrodollar surpluses through US Treasury markets after 1974, the security and development commitments that accompanied them, and the regulatory choices that drove American financialization were not spontaneous market outcomes. They were decisions made by identifiable actors at identifiable moments, and any account of how dollar dominance was built, and how it might erode, must engage with them directly rather than dissolve them into the self-referential dynamics of financial circulation.

The construction question has not been entirely ignored. Strange (1971a, 1971b) distinguished a Top Currency, whose international use rests on the economic leadership of the issuing state, from a Negotiated Currency, whose use requires the issuer to offer political, military, economic and financial inducements to its holders. She already placed the dollar in the second category from the late 1960s. Spiro (1999) and Wight (2021) have since documented the recycling of Gulf surpluses in detail. What has not been done is to bring this political economy of negotiated dollar demand to bear on the causal chain that the reserve currency literature takes for granted. That is the contribution of the present paper.

The popular post-1971 reading of the Triffin dilemma holds that issuing the global reserve currency necessarily requires running persistent current account deficits. The rest of the world can only accumulate the reserve currency if the issuing country imports more than it exports, sending its currency abroad through the trade account. The claim is widely repeated and often treated as settled, but it does not survive close historical examination. The United States ran current account surpluses throughout most of the Bretton Woods period while the dollar served as the primary reserve currency. Britain supplied sterling to the world through capital exports, not trade deficits. And in a pure fiat system there are multiple channels through which a reserve currency issuer can supply liquidity to the rest of the world, of which the current account is only one. Bordo and McCauley (2018) have documented this with precision. The supposed CA deficit requirement is best read as a generalisation from one historically specific institutional configuration rather than a structural law of reserve currency systems.

That correction, however, opens a different question. If current account deficits were not structurally required, why did the United States run them so persistently after 1971, and why did dollar hegemony strengthen rather than weaken as American industrial competitiveness declined? The answer lies not in

economic fundamentals but in a deliberate geopolitical construction. The 1973 oil shock multiplied the dollar revenues of the oil exporters, since oil had been priced and traded in dollars since the post-war posted price system. The question for Washington was where those revenues would go. In 1974 the United States and Saudi Arabia built a set of bilateral arrangements to answer it. The Joint Statement of 8 June 1974 created two joint commissions, one on economic cooperation and one on Saudi defence requirements. In parallel, the Treasury opened a confidential channel through which the Saudi Arabian Monetary Agency would invest a large share of its surpluses in US government securities. By the autumn of 1974 the Saudi government had taken what its central bank governor called a political decision at the highest level to invest at least six billion dollars a year in US securities, on condition of complete confidentiality (US Department of State, 1974). These arrangements secured a large and politically anchored demand for US government debt that did not depend on the performance of American industry. On this reading, the conventional sequence running from American economic strength to monetary privilege is reversed: the privilege was secured first, through statecraft, and the deficits and financialization that followed were enabled by the insulation it provided. Section 4 develops this argument in detail.

The existing literature has not fully pursued what follows from this. If financialization was enabled by that insulation rather than being a structural consequence of reserve currency status, then the association between the two is historically contingent rather than logically necessary. The specific regulatory choices of the 1980s, the shareholder value revolution, the dismantling of capital controls, the tax treatment of financial versus productive investment: each was a discrete political decision, not an automatic outcome of holding reserve currency status. A state with different institutional arrangements could in principle have maintained that status without replicating the American trajectory. Whether that was politically achievable in the US context is a separate question. The point is that the outcome was not predetermined by the monetary role, and treating it as if it were has produced a theoretical literature that mistakes the history of one country's political economy for a universal structural law.

The paper proceeds as follows. Section 2 develops the theoretical framework, tracing the history of the international monetary system from the gold standard through the petrodollar order and engaging with the two dominant framings of dollar hegemony and the analytical question that neither has placed at the centre of its enquiry. Section 3 interrogates the causal chain directly, working through its key links and identifying where the claims hold and where they do not. Section 4 develops the petrodollar argument, documenting the 1974 arrangements on the basis of declassified US records, their mechanism, and the inversion of causality it implies. Section 5 reconstructs the framework on more defensible foundations. Section 6 concludes and identifies the open question the analysis raises but cannot resolve, which is taken up in a companion paper examining China's emerging monetary strategy.

2. Theoretical Framework: GRC Functions and the Historical Arc

A global reserve currency performs three distinct functions in the international monetary system. It serves as the primary medium of international exchange, the principal unit of account for cross-border trade and financial contracts, and the dominant store of value in which central banks hold their foreign exchange reserves. These functions reinforce each other: widespread use as a unit of account generates demand as a medium of exchange, and that demand deepens the liquidity that makes the currency attractive as a store of value. The Post Keynesian literature on currency hierarchy argues that these functions are not distributed

symmetrically across currencies but concentrated at the apex of an international monetary pyramid, with the dollar occupying the dominant position (Kaltenbrunner and Lysandrou, 2017; Bonizzi, Kaltenbrunner and Michell, 2019).

The concentration of all three functions in a single national currency confers what Valéry Giscard d'Estaing famously called the exorbitant privilege. The issuing country can borrow in its own currency at lower rates than other sovereigns, can finance persistent external deficits without the exchange rate penalty that would normally follow, and can conduct monetary policy primarily for domestic purposes rather than in deference to external balance constraints. These advantages are real. They are also, as this paper argues, contingent on specific institutional and geopolitical arrangements rather than on the economic merits of the issuing country.

The gold standard of the nineteenth century organised the international monetary system around a commodity anchor. Sterling served as the primary vehicle currency for international trade and finance, but its credibility rested on the Bank of England's commitment to convertibility at a fixed parity. Keynes (1930) identified the fundamental problem: the adjustment mechanism was asymmetric. Deficit countries faced deflationary pressure as gold outflows forced contraction, while surplus countries could accumulate without any equivalent obligation to expand. The system preserved the purchasing power of financial claims at the expense of employment and output (Kregel, 2009).

Keynes's proposal for reform, developed in the early 1940s, was the International Clearing Union. Its centrepiece was the *Bancor*, a notional unit of account that could not be traded in private markets. The proposed adjustment mechanism was symmetric: it would impose obligations on surplus and deficit countries alike (Kregel, 2021). The proposal was rejected at Bretton Woods. The system adopted instead placed the dollar at the centre, pegged to gold at thirty-five dollars per ounce, with all other currencies fixed to the dollar. The asymmetry Keynes had identified was preserved. Surplus countries faced no active constraint on their accumulation.

Triffin (1960) identified the specific contradiction built into the Bretton Woods arrangement. The system required the United States to supply dollar liquidity to support global growth, which meant running external deficits. But the accumulation of dollar liabilities abroad would eventually exceed American gold reserves, eroding confidence in the convertibility pledge. The same deficits that allowed the system to function were expected to undermine confidence in the convertibility pledge over time. This is what Triffin actually argued: a precise claim about the tension between *gold convertibility* and *liquidity provision* under the Bretton Woods peg, not the looser claim about current account flows that has since borrowed his name (Kregel, 2010).

In August 1971, Nixon suspended gold convertibility. The decision was presented as *temporary*. It was never reversed. The Bretton Woods system dissolved, and the dollar became a pure fiat currency with no commodity anchor. What remained was its established role in invoicing, payments, and reserve holdings, and the specific geopolitical arrangements that would be constructed to sustain demand for it. How those arrangements were built, and what they actually constituted, is the subject of Section 4.

The two traditions sketched in the introduction can now be situated within this historical arc. The structural prerequisites account reads dollar dominance as the institutional expression of American economic capability. The performativity tradition, by methodological design, attends to the practices and conventions through which dollar use reproduces itself once established. The present paper draws on the second for its insistence that monetary hegemony cannot be read off industrial structure or trade flows. Neither tradition, however, asks how the conditions for these conventions were first constructed. Strange's notion of a

negotiated currency points to that question, but it has not been carried into the debate on reserve currency succession. The conventions stabilised for reasons that lie in the material and geopolitical arrangements of the 1970s, and these arrangements form part of the system's structure rather than its setting.

The structural prerequisites account treats the dollar's institutional advantages as reflections of American economic performance rather than as products of a particular political settlement. The performativity tradition takes the conventions as its starting point rather than asking what established them. What neither addresses is the role of deliberate geopolitical construction in building the material conditions on which dollar hegemony has rested, and these conditions form part of the system's structure rather than its setting.

3. Interrogating the Causal Chain: Three Links and Their Validity

3.1 Does GRC Status Require Persistent CA Deficits?

The most widely repeated claim in the literature on reserve currency succession is that the issuing country must run persistent current account deficits (Prasad, 2021; Eichengreen and Kawai, 2014). Figure 2 maps the full structure of this argument as it appears in the standard literature, identifying each link in the chain before examining their validity in turn.

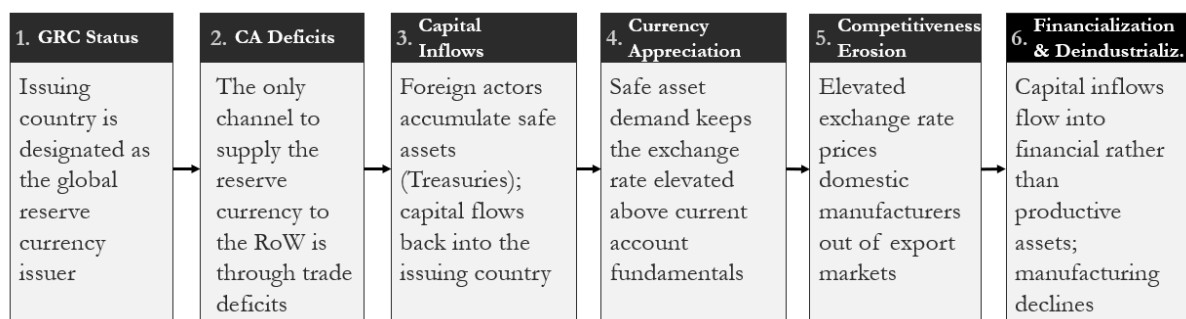


Figure 2. The Conventional Causal Chain: Global Reserve Currency Status, Current Account Deficits, and Financialization

Source: Author's elaboration, based on Prasad and Ye (2012), Eichengreen and Kawai (2014), and Bordo and McCauley (2018)

The logic seems intuitive: if the rest of the world needs to accumulate the reserve currency, it can only do so if the issuing country sends that currency abroad, and current account deficits are the mechanism by which this happens. Therefore, the story goes, the global reserve currency issuer must run a current account deficit in order to supply the reserves demanded by the rest of the world. The claim has been repeated so often, and treated as so self-evident given the US experience of recent decades, that it has acquired the status of a structural law. World Bank data tracking the US current account balance as a share of GDP from 1970 onward show a structural shift into persistent deficit from the early 1980s, deepening markedly through the 1990s and 2000s. Such a pattern has led many scholars to mistake a historically specific trajectory for an iron law of reserve currency issuance ([World Bank, 2024](#)). Figure 3 illustrates why this claim has seemed so compelling. Figure 4 shows why it is nonetheless wrong.

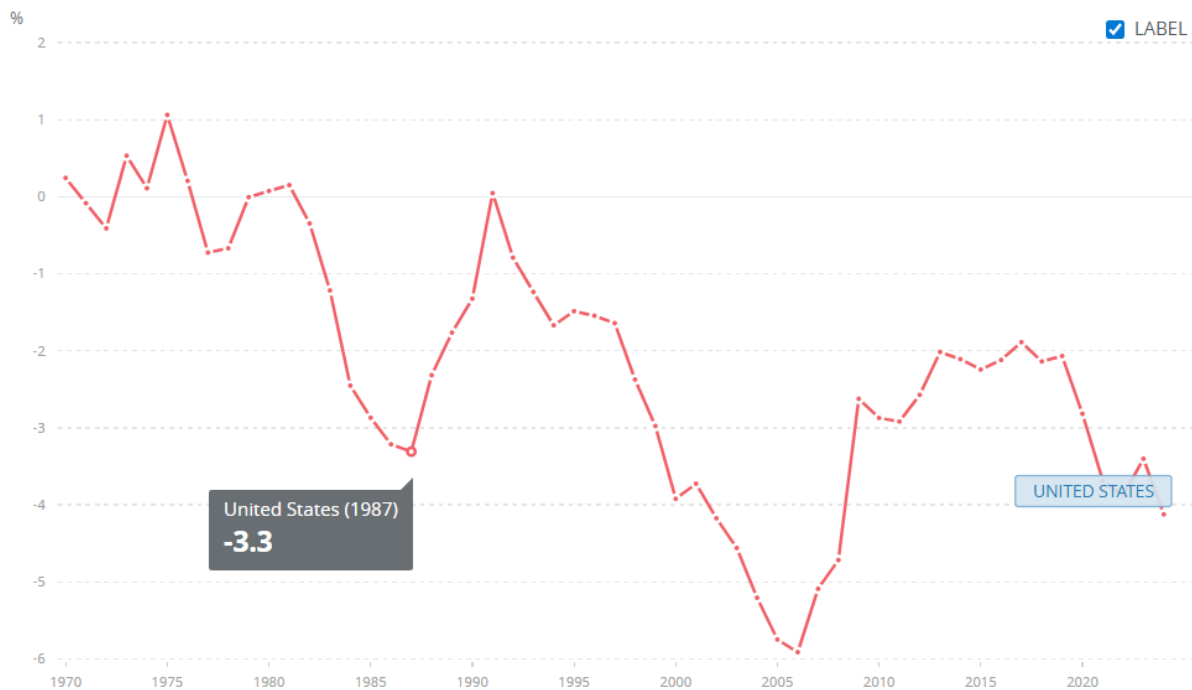


Figure 3. US Current Account Balance as a Percentage of GDP (1970–2023)

Source: World Bank (2024). <https://data.worldbank.org/indicator/BN.CAB.XOKA.GD.ZS?locations=US>

Bordo and McCauley (2018, p. 1) document its prevalence across the literature, urging a revision of the widespread view that the dollar's reserve role required US current account deficits, which they characterise as "popular, but anachronistic, and flawed in logic and fact". Kregel (2010) sharpens this point theoretically, arguing that 'the stability of the reserve currency's purchasing power is linked to an adjustment mechanism that eliminates international imbalances; it has little to do with what actually serves as the international currency' (p. 6). The current account deficit is one historically dominant channel for supplying the reserve currency abroad, but in a pure fiat system that function can equally be performed through capital exports, offshore credit creation, central bank swap lines, or commodity market denomination — none of which require a current account deficit to be recorded.

Obstfeld (2025, p. 157) reaches the same conclusion independently, noting that "the idea that the global demand for dollar assets can be satisfied only through U.S. current account deficits is widespread but wrong". The historical record confirms their verdict. The United States ran current account surpluses for most of the Bretton Woods period, from the late 1940s through the mid-1960s, while the dollar was already functioning as the world's primary reserve currency. Figure 4 makes this visible directly. These surpluses cover roughly two decades of dollar dominance and cannot be treated as a transitional anomaly within the popular reading of Triffin.

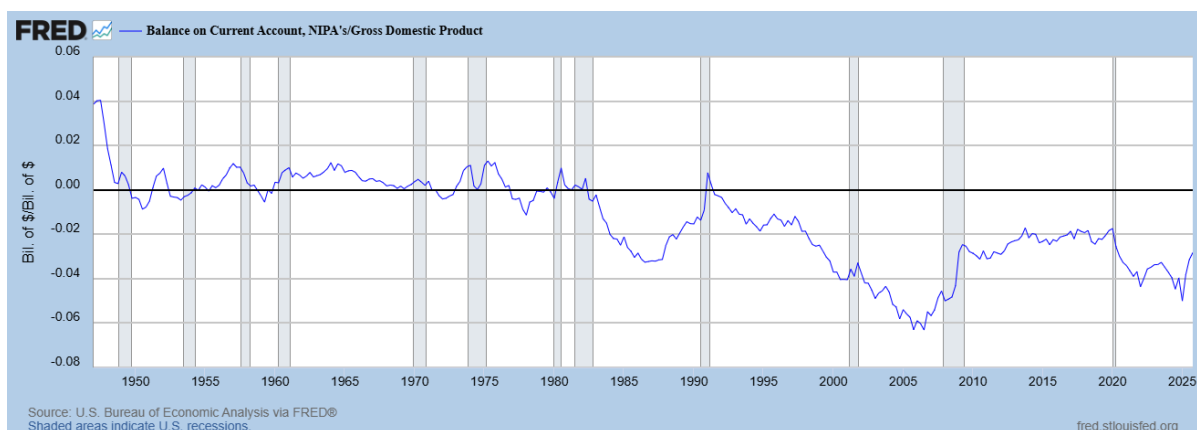


Figure 4. [Balance on Current Account, NIPA's/Gross Domestic Product](#)

Source: [FRED](#) | [St. Louis Fed](#)

Britain under the gold standard presents the same problem from a different angle. Sterling was the dominant international currency throughout the nineteenth century and into the early twentieth, yet Britain consistently ran current account surpluses. It supplied sterling to the world not through current account deficits but through capital exports: loans to foreign governments, investment in overseas railways and infrastructure, and the financial intermediation that London performed for the global economy. The reserve currency circulated internationally because British capital was flowing outward, not because British trade was in deficit.

The contrast with the post-1971 United States could hardly be starker. Where Britain ran current account surpluses and exported capital outward, the United States ran current account deficits and absorbed capital inflows. Both sustained reserve currency status for decades. If that status required a specific balance of payments configuration, the two cases could not both exist. They do, and that is the empirical refutation of the necessity claim in its simplest form.

One might object that Britain's configuration was specific to the gold standard era, where convertibility rather than monetary hegemony anchored sterling's credibility. The objection has force but does not rescue the necessity claim. The United States itself ran current account surpluses throughout most of the Bretton Woods period while the dollar already served as the primary reserve currency — and Bretton Woods was a dollar-anchored system, not a gold standard in the classical sense. If the necessity claim held, it should have applied there too. It did not.

Bordo and McCauley (2018) have made this argument with precision and documentary care. The current account version of the Triffin dilemma, they show, is a post-hoc rationalisation of the American experience after 1971, not a logical property of reserve currency systems in general. Triffin's original 1960 argument was specific and precise: it concerned the tension between gold convertibility and the need to supply dollar liquidity under the Bretton Woods peg. Once that peg was abandoned in 1971, the original logical structure of the dilemma dissolved with it. What survived was a looser and historically questionable claim about current account flows, which borrowed the prestige of Triffin's name without inheriting the rigour of his argument.

In a pure fiat system — as the dollar has been since 1971 — the current account is only one of several channels through which a reserve currency issuer can supply its currency to the rest of the world. Capital account outflows, including foreign direct investment, portfolio investment, and overseas lending, send the reserve currency abroad without any current account deficit being recorded. The Eurodollar market, which

grew substantially from the 1960s onward, created dollar liquidity through offshore credit creation entirely independent of the US balance of payments. Central bank swap lines, as demonstrated in 2008 and again in 2020, supply dollars directly to foreign central banks with no trade content whatsoever. Official transfers, military expenditure, and foreign aid channel the reserve currency abroad through fiscal and geopolitical rather than commercial mechanisms. Dollar invoicing of oil and other commodities generates working balances in dollars across all importing countries, whether or not they trade with the United States. Table 1 summarises these channels and makes the point visually: only one of the six requires a current account deficit.

Table 1. Alternative Channels for Reserve Currency Supply in a Pure Fiat System

Channel	Mechanism	CA Deficit Required?
Capital account outflows	FDI, portfolio investment, overseas lending	No
Offshore credit creation	Eurodollar market, bank balance sheets	No
Central bank swap lines	Direct dollar provision to foreign central banks	No
Official transfers	Military expenditure, foreign aid, grants	No
Commodity invoicing	Dollar pricing of oil and other commodities; working and precautionary balances	No
Current account deficit	Trade imbalance, net imports	Yes

Source: Author's elaboration, based on Bordo and McCauley (2018) and Kregel (2010).

The current account deficit is one historically dominant channel among several, made dominant by specific policy choices in a specific institutional environment. Figure 3 shows precisely when it became dominant and how it deepened over time. The initial break from surplus to deficit is visible in the early 1970s, but the sustained deterioration into persistent deficit begins around 1982 and tracks the deregulatory and geopolitical choices of the following decades, not any inherent logic of reserve currency issuance.

3.2 Exchange Rates, Capital Inflows, and Financialization

A persistent current account deficit must, by accounting identity, be matched by a financial account surplus — the issuing country must attract sufficient foreign capital to finance what it spends abroad in excess of what it earns. The standard narrative offers an explanation for why capital keeps flowing into a reserve currency country despite its persistent current account deficits. One version points to economic dynamism: superior innovation, productive investment, and a skilled labour force generate returns attractive enough to draw foreign capital regardless of the trade balance (Prasad and Ye, 2012). A second, more modest version does not claim exceptional returns but argues that the size, stability, and institutional credibility of the issuing country make its assets uniquely safe. This is the safe asset argument developed most influentially by Caballero, Farhi and Gourinchas (2008) and implicit in Bernanke's (2005) global savings glut hypothesis. On

both accounts, the capital account surplus that sustains the reserve currency role reflects the underlying economic merits of the issuing country.

The second link in the standard causal chain holds that current account deficits erode the industrial base of the reserve currency country. To finance those deficits, the issuing country must attract sufficient foreign capital. That inflow produces a financial account surplus and appreciates the exchange rate. As dollars flow out through the current account deficit, the argument goes, demand for dollar assets keeps the exchange rate elevated, pricing domestic manufacturers out of export markets and accelerating deindustrialization. This trajectory, it is often argued, is precisely what makes reserve currency status unattractive to Chinese leadership. The mechanism seems straightforward. The problem is that it identifies the wrong starting point.

The exchange rate appreciation that reserve currency countries experience does not originate in the current account. It originates in the financial account. What keeps the dollar persistently overvalued relative to US current account fundamentals is the sustained global demand for dollar-denominated safe assets (Caballero, Farhi and Gourinchas, 2008). Foreign central banks, sovereign wealth funds, and private investors accumulate US Treasury securities because they are perceived as the world's most liquid and reliable store of value. That demand generates a capital account surplus, appreciating the exchange rate and eroding export competitiveness. The current account deficit follows from this. Rather than being the inevitable burden of reserve currency issuance, it is the absorption capacity that the financial account surplus has already made available, and it is on this basis that the United States has been able to import on a sustained scale without the exchange rate penalty that would normally constrain such a position, including the imports that sustain its global military presence.

Getting the causal direction right changes what kind of intervention could interrupt the transmission mechanism. If appreciation originated in the current account — and if current account deficits were the only mechanism for supplying the global reserve currency — the only remedy would be to reduce the deficit directly. But if appreciation originates in safe asset demand flowing through the financial account, a state with capital controls could interrupt the transmission before it reaches the exchange rate and the traded goods sector. Controls on capital inflows would reduce upward pressure on the currency without requiring any change in trade flows.

The petrodollar recycling circuit reinforced this dynamic in a way that the standard account does not capture. Petrodollar surpluses flowing into US Treasury markets from the mid-1970s onward constituted a structural source of capital account surplus entirely independent of US economic performance. Saudi Arabia was not buying Treasuries simply because it had made a positive assessment of American institutional quality or growth prospects. It was buying them because of a political decision taken in Riyadh within the framework described in Section 4, which gave its monetary agency confidential access to the Treasury market. The exchange rate appreciation this generated, and the competitiveness erosion that followed, were products of a geopolitical construction rather than automatic consequences of reserve currency status.

It is part of what makes China's capital account management a deliberate strategic choice rather than a sign of financial underdevelopment, as the standard literature tends to assume (Prasad and Ye, 2012; Prasad, 2021). The question is not whether China can open its capital account, but whether it has judged that doing so would be worth the cost.

Safe asset demand is itself not a natural or spontaneous phenomenon. What generated and sustained it, and what made the petrodollar arrangement the real foundation of post-1971 dollar hegemony rather than American economic merit, is the subject of Section 4.

3.3 Capital Inflows and the Financialization Dynamic

The third link holds that capital inflows into the reserve currency country inevitably flow into financial rather than productive assets, generating the financialization dynamic that has hollowed out the American industrial economy since the 1980s. Of the three links in the standard causal chain, this one rests on the narrowest historical base.

The United States in the early postwar decades provides a more direct counterexample. Capital flowed into the American economy throughout the Bretton Woods period, yet it did not flow predominantly into financial speculation or asset inflation. It went into manufacturing, infrastructure, and productive industrial capacity, namely the productive base of an economy that had become, by the late 1950s, the world's dominant industrial power. The financialization that came to define the American economy from the 1980s onward was not a feature of this period. It emerged later, and for specific reasons.

The reserve currency role did not change. What shifted was the domestic regulatory environment within which capital inflows were received. The dismantling of the Bretton Woods capital controls framework in the early 1970s opened the financial account to large-scale speculative flows. The deregulation of financial markets through the late 1970s and 1980s, including the effective erosion of the Glass-Steagall separation between commercial and investment banking, redirected institutional capital toward financial assets. The shareholder value revolution, which took hold in American corporate governance from the early 1980s, incentivised firms to return capital to shareholders through buybacks and dividends rather than invest in productive capacity. The tax treatment of capital gains relative to labour income systematically favoured financial over productive investment. Each of these was a discrete political choice, not a structural consequence of holding reserve currency status.

The implication is that the association between reserve currency issuance and financialization, real and consequential as it has been in the American case, describes a historically specific political economy trajectory rather than a necessary outcome. A reserve currency issuer with different institutional arrangements could have received the same capital inflows and directed them differently. The theoretical literature that treats financialization as a universal outcome of reserve currency status has mistaken one country's regulatory history for a general law.

4. The Petrodollar Order: Geopolitical Construction as Monetary Foundation

4.1 The Strategic Problem After 1971 and the Secret 1974 Arrangements

Within the Bretton Woods system, every currency was pegged to the dollar at a fixed rate, and the dollar was itself convertible to gold at thirty-five dollars per ounce. Nixon suspended that convertibility in August 1971, presenting the decision as *temporary*. It was never reversed. With it went the one feature that gave foreign holders an objective reason to accumulate dollars. Under Bretton Woods, a dollar was a claim on a fixed quantity of gold. After 1971 it was a claim on nothing except the future willingness of the United States to honour its obligations (Bibi, 2026). Convertibility was not the only source of dollar demand. The Bretton Woods parity system had already obliged other central banks to hold dollar inventories, and a growing share of international bank lending was denominated in dollars, which obliged borrowers to acquire dollars to service their debts. These sources of demand were real, but they were largely private, cyclical and exposed to shifts in confidence. The United States was registering current account deficits for the first time since the

interwar period, and its industrial competitiveness was visibly eroding relative to West Germany and Japan. This was not an obvious foundation for continued monetary hegemony.

The Eurodollar market had already demonstrated, through the 1960s, that dollar liquidity could be created and sustained through mechanisms other than US economic performance. Dollars accumulated in European banks, partly to escape American financial regulation, had created a vast offshore pool of dollar credit that circulated independently of the US balance of payments. Dollar demand was therefore already shaped by institutional structures with some momentum of their own, although the Eurodollar pool alone was too narrow and too European to anchor the fiat dollar system globally. What was needed was a more durable and universal source of structural dollar demand, one that would compel countries to hold dollars regardless of their assessment of American economic prospects.

As Varoufakis recounts ([Thinkers Forum, 2024](#)), by the end of the 1960s American policymakers were aware that, historically, every empire that began registering current account deficits had eventually lost its imperial position. When Kissinger asked his economists for a solution, Volcker's answer — to *triple* the deficit and make foreigners pay for it — was unorthodox to say the least. When pressed on whether this would cause the dollar to deteriorate over time, Volcker replied:

“No. Not as long as the USD is THE ONLY World Reserve Currency, the only currency that has demand: people demand it, even if they don't want to buy anything from the country which is producing it, which is printing it.”²

From this, Varoufakis concludes that American hegemony rested not on economic strength but on the monopoly of the payment system and that this is why, in his words, the United States '*can afford to be the big bully around the world*'. On Varoufakis's reading, the deficit was less a problem to manage than a lever to use.

Varoufakis's reading echoes an older argument in international political economy. Strange (1971b) distinguished a Top Currency, whose international use rests on the economic leadership of the issuing state, from a Political or Negotiated Currency, whose use depends on political, military, economic and financial inducements offered to its holders. She already placed the dollar of the late 1960s in the second category. The oil shock of 1973 raised the stakes of this negotiation. It transferred a large share of world savings to a small number of states whose security depended on the United States, and whose surpluses could either support or destabilise the dollar. What remained to be settled was the form the bargain would take.

The construction took the form of several linked arrangements negotiated during 1974. The Joint Statement on Cooperation signed by Prince Fahd and Henry Kissinger on 8 June 1974 established a Joint Commission on Economic Cooperation, chaired by the US Treasury Secretary and the Saudi Minister of State for Finance and National Economy, and a second commission to review the modernisation of the Saudi armed forces. The public text said almost nothing about money. It stated only that the US Treasury and the Saudi Ministry of Finance “will consider cooperation in the field of finance” (US Department of State, 1974a). The substance of that cooperation was settled in confidence. During his visit to Jeddah in July 1974, Treasury Secretary William Simon left a letter with the Governor of the Saudi Arabian Monetary Agency, Anwar Ali, setting out an illustrative scale of investment. At a meeting in Washington on 30 September, Ali

² This is the transcript of Yanis Varoufakis speech in [“How China Can Win the Cold War with the U.S., Here are Four Suggestions”](#) Minutes 16.52 – 21.16

informed Simon that the Saudi government had taken a political decision at the highest level to invest in US securities, mainly through the Federal Reserve Bank of New York, at a rate of at least six billion dollars a year. He insisted on complete confidentiality over the amounts and types of investment (US Department of State, 1974b).

The Treasury met this condition through two devices. Saudi purchases were made as add-ons outside the regular auctions, and Saudi holdings were reported only within an aggregate of oil-exporting countries. The arrangement was examined by the General Accounting Office in 1979, and Spiro (1999) analysed its consequences for the international monetary system. The Treasury disclosed Saudi holdings separately only in 2016, following a Freedom of Information Act request by Bloomberg (Wong, 2016). The documented core of the arrangements was the placement of Saudi USD surpluses in US government securities, in exchange for security, arms and development cooperation.

Whether the 1974 arrangements also included an understanding on the currency of oil sales remains an open question. The financial side of the arrangements was kept confidential for more than four decades, and an informal understanding of this kind need not have left a written trace. The available official records document the placement of Saudi surpluses in detail but contain no reference to the pricing of oil. Oil was already priced in dollars, so such an agreement would have confirmed and reinforced an existing practice. The question has since acquired new relevance. In 2023, Washington's terms for a new pact with Riyadh were blunt. According to the Wall Street Journal, the United States wanted assurances that Saudi Arabia would (continue to) "use U.S. dollars, not Chinese currency, to price oil sales". It also wanted no Chinese military bases in the kingdom and limits on Huawei technology (Nissenbaum, 2023). Media reports in 2024, revived during the war with Iran in 2026, claimed that a fifty-year agreement on dollar pricing had lapsed without renewal (Rogelberg, 2026). No official document supports the claim of a fixed 50 years term, and the same reports concede that the arrangement was never a formal obligation. The episode of 2023, however, shows something more important. The currency of Saudi oil sales has become an explicit object of bargaining, tied to security and technology, which is what the notion of a negotiated currency would lead us to expect. These negotiations are consistent with the existence of a tacit understanding on dollar pricing dating back to the 1970s, which the US sought to reconfirm once China had become Saudi Arabia's largest customer. They are equally consistent with the absence of any earlier commitment. Either way, the currency of Saudi oil sales has been treated in the US as part of the security relationship.

Dollar pricing of oil shaped the logic of these arrangements. Because oil was invoiced in dollars, the depreciation of the dollar after 1971 reduced the real value of producers' revenues. This was one of the grievances behind the price increases of 1973 (Yergin, 1991). Dollar pricing also meant that the United States could depreciate without raising the dollar cost of its own oil imports. The recycling arrangements addressed the other side of the same problem. They gave the largest producer a reason to keep its surpluses in dollar assets, and therefore an interest in the stability of the dollar.

4.2 The Mechanism, the Inversion of Causality and the Erosion of the Arrangement

Because oil was invoiced and settled in dollars, a convention that predates the 1974 arrangements, oil imports generated a specific kind of dollar demand. Oil cannot be deferred without immediate macroeconomic costs, so an importing country cannot tolerate any interruption in its access to dollars at the

moment of purchase. Oil shipments are large and lumpy, with payment terms short enough that the importer must have the full sum available at brief notice rather than acquire it on the spot market. And the foreign exchange market for many smaller currencies is not deep enough to absorb sudden large dollar purchases without a sharp depreciation, which would raise the domestic-currency cost of the same import and transmit inflationary pressure into the wider economy. Taken together, these features mean that any oil-importing country must hold a working stock of dollar reserves sufficient to cover several months of oil imports as a matter of basic prudential policy, regardless of its trade relationship with the United States, its assessment of American financial markets, or its view of American fiscal discipline. Dollar invoicing of oil therefore generates precautionary demand for dollar balances. These balances can, however, be held as deposits in offshore banks, and the Eurodollar market could supply them without any capital flowing into the United States. Invoicing alone does not explain, by itself, why the surpluses of the oil exporters ended up financing the American deficit. That outcome depended on where the surpluses were placed.

The implication for the global pattern of dollar holdings was immediate. After 1973, every industrial economy required dollars to purchase oil, and every industrial economy therefore had to maintain reserves on the scale just described.

The recycling circuit is the core of the mechanism. Petrodollar surpluses flowing back into US Treasury markets kept American borrowing costs lower than they would otherwise have been and kept the dollar stronger than current account fundamentals alone could have justified. The Treasury market deepened as a result, which attracted further non-oil inflows seeking safe and liquid assets, which deepened the market further, which reinforced its safe asset status. Each element of the circuit strengthened the others. The system became self-reinforcing in a way that was largely independent of US economic performance.

This is where the standard causal account of dollar hegemony breaks down most clearly. The conventional story runs from underlying economic strength to monetary privilege: the dollar is the reserve currency because the United States is the world's largest and most productive economy, and reserve currency status brings with it the exorbitant privilege of lower borrowing costs and deficit tolerance. The petrodollar history inverts this sequence. The geopolitical arrangement came first. It *manufactured* a structural demand for dollar assets that kept the currency strong and US borrowing costs low regardless of what was happening to American industry or fiscal discipline. The privilege preceded and enabled the deficits rather than resulting from the strength that was supposed to justify it.

The further implication follows directly. If the insulation from competitive discipline came from the geopolitical arrangement rather than from economic performance, then American financialization and deindustrialization are not unfortunate side effects of an otherwise well-functioning reserve currency system. They are at least partly products of that insulation. A country that can borrow cheaply in its own currency, that faces no exchange rate penalty for running persistent deficits, and whose financial markets are structurally supported by sovereign buyers with no price sensitivity has weakened incentives to maintain industrial competitiveness or fiscal prudence. The petrodollar arrangement did not cause American deindustrialization directly. But it removed the adjustment pressures that would otherwise have constrained it.

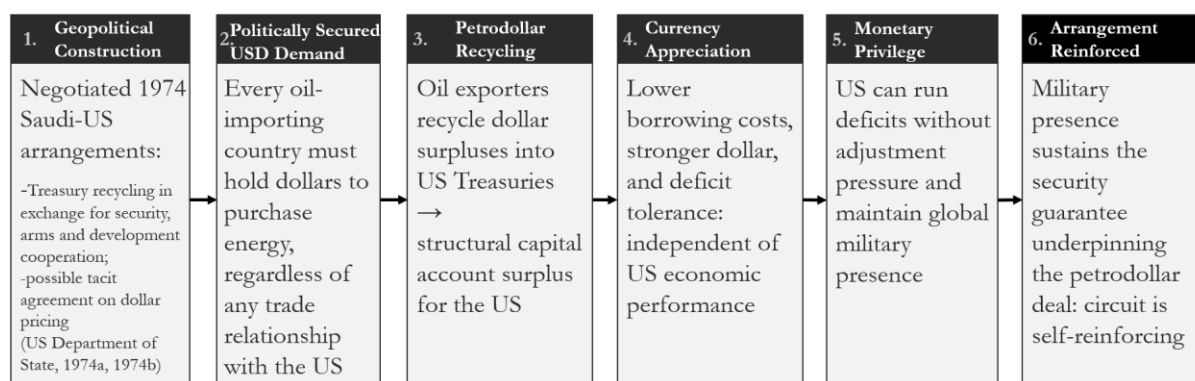


Figure 5. The Corrected Causal Chain: Geopolitical Construction, Petrodollar Recycling, and Monetary Privilege

Source: Author's elaboration, drawing on Spiro (1999), Bordo and McCauley (2018), and Varoufakis (2011)

The 1974 bilateral arrangements enter the chain first, manufacturing a structural demand for dollar assets by channelling Saudi petrodollar surpluses into US Treasury markets (and possibly through a tacit agreement on the dollar pricing of oil), while the sale of oil in dollars, a convention the bargain helped sustain, obliged every importing country to hold dollar balances. That demand sustains a capital account surplus that is largely independent of US trade competitiveness, holding the dollar exchange rate above what current account fundamentals alone would imply and keeping American borrowing costs low. The persistent current account deficit then appears in the diagram as a downstream outcome of the appreciated currency and the financial account surplus, rather than as the mechanism by which dollar reserves are supplied to the rest of the world. Financialization lies outside the chain, occurring not because reserve currency status mechanically produces it but because the structurally guaranteed inflows met a domestic regulatory environment that channelled them toward financial rather than productive assets. The diagram is intended to make visible that the standard chain has the order of dependence wrong at its first link, and that several effects the conventional account treats as separate become readable as elements of one circuit once the geopolitical foundation is placed at the start.

The circuit Figure 5 describes was self-reinforcing because each element sustained the others. Its vulnerability lay in the same place as its foundation. The geopolitical arrangement that set the mechanism in motion could itself be disrupted, and the US has acted accordingly. The demands it put to Saudi Arabia in 2023 on oil pricing, Chinese military bases and Huawei technology were an attempt to continue securing the first link of the chain (Nissenbaum, 2023). If that link weakens, the circuit can survive for some time on the inertia of the safe asset convention. What it loses is the political anchor that held the other elements in place.

The arrangements of 1974 had no fixed term, and their erosion has been gradual. A trade and investment agreement signed in 2003 still acknowledges the Joint Statement of 1974 as a prior agreement in force (United States & Saudi Arabia, 2003). What has changed is the context. The shale revolution has reduced American dependence on Gulf oil. In 2016 the Treasury ended the confidential treatment of Saudi holdings. China has become Saudi Arabia's largest oil customer, and in December 2022 President Xi Jinping announced that China would use the Shanghai Petroleum and Natural Gas Exchange for yuan settlement of oil and gas trade with the Gulf (Reuters, 2022). In 2024 the Saudi Central Bank joined the mBridge platform. None of these developments dismantles the circuit. Each of them weakens the bargain on which it was built.

The US has not treated this erosion passively, and Venezuela offers the clearest recent case. Under US sanctions, China had displaced the United States as the main buyer of Venezuelan oil (Bibi & Poty, 2026). Following the US operation that removed Nicolás Maduro in January 2026, the interim Trump-backed government of Delcy Rodríguez (Phillips, 2026) agreed in August to a joint venture to develop fields with 65 billion barrels of proven reserves. According to a US official, the US government would hold 55 per cent of the venture. The text of the agreement has not been published, and accounts of its duration differ (Habeshian, 2026). Furthermore, in September 2026, the Trump-backed interim government of Delcy Rodríguez and the right-wing opposition were reported to be close to an agreement to transfer Venezuela's gold reserves, worth about 4 billion dollars, from the Bank of England to the Federal Reserve Bank of New York (Dyer et al., 2026). Taken together, these steps would bring both the oil and the reserve assets of a major producer back within the American financial system. The construction described in this paper is therefore not only a matter of history. It continues, and its methods have become more direct.

This erosion matters more than accounts grounded in economic fundamentals would suggest. The safe asset status of US Treasuries has its own momentum, the oil market's dollar conventions have enormous inertia, and no alternative arrangement is yet capable of handling transactions at the scale the dollar system currently manages. Had dollar hegemony rested primarily on American economic fundamentals, the weakening of a bilateral security bargain would be a minor diplomatic development. The attention that markets and policymakers now give to it suggests otherwise. The arrangement did not merely decorate an existing monetary order; it partly constituted one.

The more recent erosion also opens space that did not previously exist. Importers that hold dollars to purchase oil, and exporters that place their surpluses in dollar assets, now face a different calculation. As alternative payment infrastructures develop, as commodity pricing arrangements become more flexible, and as the security relationships underpinning the original bargain shift, the politically secured element of dollar demand is likely to weaken gradually. How far and how fast that process goes depends on what replaces the petrodollar architecture. China's monetary strategy is the obvious place to look, and it is the subject of the open question raised in the conclusion.

5. Reconstructing the Framework

The analysis in the preceding sections has dismantled three links in the standard causal chain. What needs to be built in their place is not just a corrected sequence of causes and effects but a different way of understanding the dollar's reserve currency status, how it is sustained, and what costs it does and does not necessarily produce.

The structural prerequisites literature and the performativity tradition reach different conclusions about the foundations of dollar hegemony, but both tend to focus on the mechanisms through which the dollar system reproduces itself rather than on the conditions under which it was originally constructed. What both tend to bracket, for understandable methodological reasons, is the role of deliberate political construction in establishing those conditions. The petrodollar arrangement is the clearest evidence of this gap. It was a secret bilateral deal negotiated by state actors pursuing strategic objectives, rather than a market outcome or a convention emerging from the practices of financial intermediaries, and it manufactured the structural dollar demand on which the self-reinforcing dynamics of the Treasury market and dollar invoicing later operated.

Understanding why the conventions stabilised requires asking what constructed the conditions for their stabilisation, a question the petrodollar history brings into focus.

What the preceding analysis supports is a two-pillar account of post-1971 dollar hegemony. The first pillar is the petrodollar arrangement itself. By compelling every oil-importing country to maintain dollar reserves regardless of its trade relationship with the United States or its assessment of American economic prospects, the secret agreement created a floor under dollar demand that was *geopolitical* rather than *economic* in origin. This is qualitatively different from the kind of demand that the structural prerequisites literature identifies. Safe asset demand, network effects in dollar invoicing, and the liquidity advantages of deep Treasury markets are all real and consequential, but they are demand that can in principle migrate to another currency if a sufficiently credible alternative emerges. Coerced commodity demand of the petrodollar type is stickier, because it is tied to the physical necessity of energy imports rather than to a comparative assessment of currency quality. This is not a minor terminological point: a system anchored by coerced commodity demand erodes differently, and more slowly, than one sustained by voluntary financial preference.

The second pillar is the safe asset status of US Treasury securities. This is real, but it needs to be understood as partly constructed rather than simply given. Decades of sovereign oil exporters recycling petrodollar surpluses into Treasuries deepened and stabilised the market in ways that attracted further inflows and reinforced the safe asset convention over time. The two pillars are not independent of each other. The first helped build the second. An account of dollar hegemony that focuses only on Treasury market depth and liquidity, without asking how that depth was originally established and what kept sovereign buyers purchasing regardless of yield, misses the geopolitical foundations on which the financial architecture rests.

Read against this two-pillar account, the current account deficit looks different from how both the structural prerequisites literature and the popular Triffin narrative present it. Rather than functioning as the mechanism that sustained dollar hegemony, the deficit is better understood as one of the freedoms that hegemony conferred on the United States. The structural demand generated by the petrodollar arrangement and the safe asset convention secured a *capital account surplus* that insulated the United States from the exchange rate adjustment that persistent current account deficits would normally produce. The US could run deficits without triggering a dollar crisis because the financial account surplus was structurally guaranteed by arrangements that had nothing to do with trade competitiveness.

The same insulation that allowed the United States to run persistent deficits without exchange rate adjustment also relaxed the fiscal and macroeconomic constraints that would normally have forced tradeoffs between civilian and military expenditure. Reserve currency status did not cause American militarisation, but it removed one of the disciplinary mechanisms that would otherwise have made its scale costlier to sustain. This is a separate channel from the absorption argument developed in Section 3.2, operating through the softening of the budget constraint rather than through the exchange rate, and it deserves more sustained attention than the existing literature has given it.

Treating the deficit as the source of hegemony rather than its product rests on an empirical claim the conventional narrative takes as settled: that safe asset status and Treasury market depth reflect underlying American institutional quality. The petrodollar history reveals a reverse causality. Sovereign oil exporters were not buying Treasuries because they had assessed American institutions favourably. They were buying them because the bilateral arrangement made it the expected and incentivised use of their dollar revenues. On this reading the foundations of dollar hegemony were partly constructed through statecraft rather than simply revealed by market processes. Figure 6 places the two accounts side by side. The annotations on the

conventional chain mark the specific links the preceding sections have contested, while the corrected chain makes visible the temporal sequence in which monetary privilege precedes industrial decline rather than following from it, and the place of military reach within the self-reinforcing circuit.

CONVENTIONAL ACCOUNT (standard literature)		CORRECTED ACCOUNT (this paper)
1 GRC Status <i>Issuer designated as reserve currency</i>		1 Geopolitical construction <i>1974 Saudi-US petrodollar deal — statecraft, not market outcome (US Department of State, 1974a, 1974b)</i>
2 CA Deficits required <i>"Only way" to supply reserves — the paper's primary target</i>		2 Politically Secured USD demand <i>Oil priced in USD → importers must hold dollars, independent of US trade performance</i>
3 Capital inflows <i>Foreign safe asset demand returns capital to issuing country</i>		3 Petrodollar recycling <i>Surpluses → confidential Treasury add-ons → structural capital account surplus for the US</i>
4 Currency appreciation <i>Exchange rate elevated → competitiveness erodes (causation reversed in this paper)</i>	vs.	4 Monetary privilege (first) <i>Low rates and deficit capacity arrive before — not after — industrial decline</i>
5 Financialization <i>Capital flows into finance, not production (contingent, not necessary)</i>		5 Deficit capacity and military reach <i>Privilege enables spending and military presence that reinforce the arrangement</i>
6 Deindustrialization <i>Manufacturing hollowed out — treated as unavoidable structural cost</i>		6 Arrangement reinforced <i>Security guarantee sustained → self-reinforcing circuit independent of fundamentals</i>

Figure 6. The Standard versus Corrected Causal Chain: A Comparison

Source: Author's elaboration, based on Prasad and Ye (2012), Eichengreen and Kawai (2014), Bordo and McCauley (2018), Kregel (2010), Strange (1971b), US Department of State (1974a, 1974b), Spiro (1999) and Varoufakis (2011).

The financialization question follows the same logic, and here the corrected framework has its most direct implications for the performativity literature. MacKenzie (2006), Langley (2008), and Bryan and Rafferty (2006) are right that financial conventions, once established, develop self-reinforcing dynamics that cannot be reduced to underlying economic fundamentals. Dollar invoicing locks in, Treasury markets deepen, and the cost of switching rises with the scale of existing commitments. The performativity framework has been more attentive to the mechanisms of reproduction than to the prior question of construction — which is understandable given its methodological commitments but leaves a gap that the petrodollar history makes visible. The petrodollar history suggests that the construction question deserves more sustained attention than either tradition has given it. The conventions stabilised because the geopolitical arrangement provided a material foundation on which they could stabilise. Remove that foundation and the conventions become vulnerable in ways that a purely performative account does not easily accommodate.

For financialization specifically, the corrected framework shows that the channelling of capital inflows into financial rather than productive assets was not a structural consequence of reserve currency status but a product of the intersection between structurally guaranteed inflows and a specific domestic regulatory environment. The inflows were guaranteed by the petrodollar arrangement and safe asset convention. Their destination was determined by deregulation, the shareholder value revolution, and the removal of capital controls. A reserve currency issuer with strong industrial policy, capital controls, and a different corporate governance framework would have faced the same inflows but could in principle have directed them differently. The United States itself in the early postwar decades is the more direct evidence for this possibility: capital flowed into the American economy throughout the Bretton Woods period and went into manufacturing and productive capacity rather than financial speculation. The British case in the nineteenth century points in the same direction, imperfect as any historical analogy across monetary regimes must be.

What it shows is that the outcome is not predetermined by the monetary role, and that treating it as if it were has produced a theoretical literature that cannot distinguish between the *necessary* and the *contingent* in the American experience.

The broader implication for monetary theory is this. Reserve currency status is a political achievement, not a market outcome. It requires active construction through statecraft, security provision, and institutional design. It confers privileges that are real but contingent on the political arrangements that sustain them. And it generates costs that are shaped by domestic institutional choices rather than by the reserve currency role itself. A framework that takes this seriously would extend both traditions by asking not just what economic conditions or self-reinforcing conventions sustain reserve currency status, but what geopolitical relationships constructed the conditions for those conventions to stabilise in the first place. Those are questions that monetary economics has largely left to international relations, and that international political economy has engaged with unevenly. Bringing them into the centre of the analysis is what the corrected framework requires.

6. Conclusions and Open Questions

The paper opened with a puzzle. The dollar's share of global reserves has been declining for two decades. The petrodollar agreement that anchored the post-1971 system has lapsed. Russia, China, and a growing number of other states are actively building payment infrastructure that bypasses the dollar. And yet the existing literature either treats dollar hegemony as resting on economic fundamentals that remain largely intact, or focuses on the self-reinforcing conventions of financial markets without asking what originally constructed those conventions or what is now eroding them. Neither framing is fully equipped to explain what is happening. The structural prerequisites account looks for eroding fundamentals and finds them only partially. The performativity tradition, given its methodological commitments, has less to say about the conditions whose erosion is now in progress.

This paper has argued that the post-1971 dollar system rested primarily on a *deliberate geopolitical construction* rather than on underlying American *economic strength*. The 1974 petrodollar arrangement manufactured structural dollar demand by tying oil pricing to the dollar through a bilateral *secret* security deal and extending that convention across the global oil market. This reverses the conventional causal story. The relevant privilege was secured through statecraft and maintained through the security relationships that kept the oil denomination convention in place. The current account deficits that the popular Triffin narrative treats as the mechanism of reserve currency supply were not the source of dollar hegemony. They were enabled by it, made sustainable by the capital account surplus that the petrodollar recycling circuit and safe asset demand guaranteed regardless of US trade performance.

The financialization that accompanied dollar hegemony was a *contingent outcome, not a structural necessity*. Britain supplied sterling to the world in the nineteenth century without financializing its economy in the way the United States did after 1971. The difference was not the reserve currency role but the domestic regulatory framework within which capital inflows were received and deployed. American financialization was the product of *deregulation*, the shareholder value revolution, and the removal of capital controls, each a discrete political decision taken in a specific institutional context. A reserve currency issuer with different institutional arrangements could have (and still could) maintained that status without replicating the American trajectory.

The argument does not end with the American case. Monetary power is statecraft. It is constructed through specific institutional arrangements, maintained through political and security relationships, and vulnerable to the erosion of those relationships in ways that accounts grounded in economics alone cannot capture. Treating reserve currency status as a *natural and spontaneous* feature of the international economic landscape rather than as a political achievement produces a literature that cannot distinguish between what the American experience required and what it merely produced.

The 2024 expiry of the Saudi petrodollar agreement is, on this reading, the first visible structural crack in the institutional architecture that has sustained dollar dominance for fifty years. The 2024 expiry does not collapse the system, given the inertia of the safe asset pillar and of oil market conventions, but it removes a foundation that was doing real work and opens space for alternative constructions to develop. Whether any such construction is coherent and durable enough to displace the existing one depends on questions this paper has raised but cannot resolve.

The most important of those questions concerns China. Its persistent current account surpluses, managed capital account, gold accumulation, and gradual yuan internationalization are conventionally read as obstacles to reserve currency status. The analysis developed here suggests they are better read as the institutional expression of a deliberate judgment: that the political economy trajectory associated with fiat reserve currency issuance, under the specific conditions of the current international monetary system, is incompatible with the development model China is still executing. Whether China is also attempting to construct a parallel petrodollar-type mechanism through its Gulf relationships, petroyuan initiatives, and cross-border CBDC infrastructure, and whether such a construction could generate the trust and network effects that reserve currency status requires, is the question future research should take up. What this paper has tried to establish is the analytical framework within which that question can be asked clearly.

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Funding details.

No fundings obtained for this research project.

Disclosure statement.

The authors report there are no competing interests to declare.