TOWARDS A THEORY OF CURRENCY GEOECONOMICS

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AUTHOR'S DECLARATION

I, the undersigned, **Mohammad Javad Alemi**, candidate for the MA2 degree in Political Science declare herewith that the present thesis is exclusively my own work, based on my research and only such external information as properly credited in notes and bibliography. I declare that no unidentified and illegitimate use was made of the work of others, and no part of the thesis infringes on any person's or institution's copyright. I also declare that no part of the thesis has been submitted in this form to any other institution of higher education for an academic degree.

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ABSTRACT

Unlike previous episodes, the latest wave of global backlash against the dollar in the aftermath of the Ukraine war is primarily motivated by geoeconomic concerns. This theoretical research investigates the link between dominant currencies and international politics. It specifically asks what aspect of currency dominance is the most geoeconomically potent. This potential is the product of the issuer's ability to exploit its currency's global status for achieving strategic ends as well as the countermeasures that others can employ to balance against it. With a focus on the U.S. dollar, I decompose the 'exorbitant privilege' of international currencies into the political and economic dimensions. I argue that the global trends toward hedging against 'political risks' eventually erode the political privilege of dollar hegemony – the ability to weaponize dollar dependence in foreign exchange reserves or international payments. However, the economic privilege – the ability to run large and enduring current account deficits – continues supplying the United States with resources to finance its strategies.

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FXR:	Foreign Exchange Reserves
GEO:	Geoeconomic Order
IO:	International Organization
IPE:	International Political Economy
LIO:	Liberal International Order

INTRODUCTION

On June 7th, 2023, the United States House Committee on Financial Services hosted a hearing entitled: “Dollar Dominance: Preserving the U.S. Dollar’s Status as the Global Reserve Currency” (Dollar Dominance 2023). “Probably the most important hearing [during] this entire Congress”[1] was held at a time when “pessimism about the dollar’s future abounds” (Norrlöf 2023b). Ever since the Ukraine war culminated in 2022, so did the calls for ‘de-dollarization’ by ambitious leaders around the world in favor of limiting the greenback’s influence over global economic affairs (Chinadaily 2023; Devonshire-Ellis 2023; Zakaria 2023; Leahy and Lockett 2023; Abu Omar and Cranny 2023).

However, such rhetoric against the dollar’s hegemony are in no way new (Oatley 2014; Norrlöf et al. 2020). One of the earliest and most famous protests is attributed to General de Gaulle’s finance minister, Valéry Giscard d’Estaing, and his 1965 speech on the ‘exorbitant privilege’ of the United States as the issuer of the dominant currency.[2] Nevertheless, the recent wave of global backlash against the dollar in the aftermath of the Ukraine war seems primarily motivated by ‘geoeconomic’[3] concerns regarding the U.S. foreign policy, and not the macroeconomic shocks to America’s and the global economy (Weiss 2022; McDowell 2023; Norrlöf 2023a).

This research contributes to the monetary and global order debate (Norrlöf et al. 2020) by investigating the link between the international currencies, with a focus on the U.S. dollar, and the recent developments in world politics. It specifically asks what aspect of currency dominance is the most geoeconomically potent. This potential is the product of the issuer’s

[1] According to Andy Barr, the chair of the subcommittee on financial institutions and monetary policy (Dollar Dominance 2023).
[2] Although Gourinchas and Rey (2007) report a void of supporting historical evidence.
[3] The term “geoeconomics” will be more precisely defined in Chapter Two. For now, it concerns the pursuit of strategic goals via economic means (Blackwill and Harris 2016).

ability to exploit its currency's global status for achieving strategic ends as well as the countermeasures that others can employ to balance against it. To summarize the arguments put forth in this research, I decompose the exorbitant privilege to a political and an economic dimension. I highlight the global trends toward gradually hedging against "political risks"[4] that eventually erode the political privilege of dollar hegemony – the ability to weaponize dollar dependence in foreign exchange reserves (FXR) or international payments. However, the economic privilege – the ability to run large and enduring current account deficits – continues supplying the United States with financial resources to finance its strategies.

My research question reveals an incongruence between the commonly inspected side of international currencies in political science – the reserve currency role – and what they seem primarily concerned about – the strategic implications of a dominant currency. To help achieve consistency between the aims and the delivery of research in this area, among other tasks, I show that the academic speculations of the dollar's prospects in foreign exchange reserves, even if true, bear little strategic significance.

While scholars have been describing the global outlook of international currencies (Strange 1971b; Cohen 1998), studying their history (Strange 1971a; Eichengreen 2011; Dalio 2021), explaining how they work (Cohen 2015; Eichengreen, Mehl, and Chitu 2018), tracking the effect of various causes on their global status (Oatley 2014; McDowell 2023), and predicting their future (Eichengreen 2019b; Norrlöf 2022), one can hardly find a straight-forward link between dollar dominance – as considered by researchers – and its political implications as the source of policymakers' apprehension. Of course, this is not to suggest that the field lacks a general understanding of the money and power relationship (see Strange 1971b; Gilpin 1987; Strange 1987; Norrlöf 2014; Cohen 2015; Oatley 2015). Rather, it barely

[4] "The potential for a political act to raise the expected costs of using a currency for cross-border transactions or as a store of value" (McDowell 2023:5).

descends on the 'ladder of abstraction' to identify specific mechanisms through which global currencies serve political ends (Blackwill and Harris 2016).

Overlooked in this gap, are some key questions of today about the political economy of international currencies. For instance, how useful a weapon financial sanctions are in great power politics? How do the challenges of payment systems management reshape the global supply chains, and consequently, the patterns of economic interdependence? How does the U.S. politics, such as debt or inflation qualms, shape its foreign policy vis-à-vis the dollar, and what are the consequences for the regions around the world? These questions of grave importance have little to do with the greenback's share in foreign exchange reserves as the focal point of the global currencies' literature.

Recently, scholars have taken heed of the USD's role in the international payment system which enables, and concomitantly, is threatened by financial sanctions (McDowell 2020; Demarais 2022). I deviate from these studies by putting financial sanctions in the broader context of the systemic-level order. This improvement casts doubt on some prevalent policy positions. For instance, my findings suggest reassessing McDowell's recommendation (2023) that the U.S. should avoid imposing sanctions for minor issues/states and save them for the case of a serious crisis with China. To grasp episodes like Russia's unexpected resilience to an unprecedented package of sanctions (Feldstein and Brauer 2024), I will demonstrate that in great power politics, financial sanctions – and more broadly, geoeconomic means – might be redundant whenever they are feasible.

This example clarifies that this topic's importance goes beyond academia. The experts perpetuate their misunderstandings among political elites and prevent effective policymaking on all fronts: both the U.S. politicians concerned with preserving their 'financial royalty' and those who aspire to de-throne the 'American king.'

In order to examine the importance of dollar hegemony in the realm of geoeconomics, first, one should understand what a dominant currency is, and what is so special about it. Therefore, this research opens by reviewing the literature to map out the most important dimensions of the international currencies' canon. I categorize the benefits of issuing an international currency, the exorbitant privilege, into economic and political dimensions. As mentioned before, my review finds it difficult to detect a satisfactory account that would explain the importance, and thus, could justify the literature's focus on FXR.

After a comprehensive discussion of the implications and functions of an international currency, the next step for establishing the link between currency hegemony and geoeconomic potential is to understand the roots of geoeconomic concerns in their broader IPE context. This warrants a comparative study of the recent systemic-level orders and the role of the dollar under each setup. Accordingly, Chapter Two deals with the Liberal International Order (LIO) and its transition into a "Geoeconomic Order" (Roberts, Choer Moraes, and Ferguson 2019) that provokes political risks. It argues that the latter order was born out of the former, and inherits its self-destructive nature. This analysis accounts for the growing body of empirical evidence that is telltale of the expected directions of the global economy in the future. Namely, the two scenarios of decoupling and diversification. Figure 1 recaps this chapter visually.

Chapter Three brings the previous ones together to investigate the politically significant dimensions of international currencies under a geoeconomic order (GEO). Using the greenback's case, it contrasts the dollar's prospects in multiple domains under LIO and GEO. I continue by explaining how financial sanctions as the principal geoeconomic weapon of the United States confine the dollar's international role from a global public good to a club good of the Western comprehensive political-economic camp. Finally, the process of elimination leads us to understand which set of exorbitant privileges is the most consequential insofar as geoeconomics is concerned.

In conclusion, it is the debt issuance role of an international currency that merits more attention henceforward and not the much-discussed shares in the global foreign exchange reserves. Put differently, the inflow of the Foreign Exchange Reserves variable geoeconomically outweighs its stock. The greenback's domination of the reserves is not probably waning over political concerns anyway (Weiss 2022). Nonetheless, financial sanctions – as the core of the political privilege – lose their geoeconomic edge once the target is decoupled from the U.S. economy or has diversified away from total dependence on the dollar-based payment system. Whereas the 'hard power' of the United States is directly bound to its ability to cheaply, largely, and lengthily debt-finance its military costs (Oatley 2015). This ability – the economic privilege – is a function of issuing new debt and not the sum of dollar-denominated assets that the central banks have already accumulated. A summary of this research's chief arguments is provided in Table 1.

I close with a brief note on my contribution and methodology. As a theoretical piece that coins the concept of 'currency geoeconomics' at the intersection of security studies and international political economy, this research bridges various strands of literature including economics, international relations theory, international monetary and financial system, and of course, geoeconomics itself. Nevertheless, the contribution of this research is not a theoretical novelty in any of the above branches of literature, *per se*. Instead, it lies in gathering them under the umbrella of a concise and coherent framework that covers the limitations of each with the strengths of another.

Methods-wise, this research employs secondary data as empirical hunches to theorize about the geoeconomic potential of international currencies. I leave out some applicable practices of theory-building case studies (as in Rohlfing 2012) due to size limitations and their limited analytical added-value. Nonetheless, the presented framework of currency geoeconomics generates new hypotheses for empirical evaluation in future research. Moreover, shedding light on the theoretical shortcomings in the literature opens novel avenues to further theorize about the most remarkable aspects of the international political economy of global currencies.

	Liberal International Order (LIO)	Geoeconomic Order (GEO)
Systemic-Level Order	Liberal Unipolarity	Realist Multipolarity
Salient Economic Logic	Absolute Gains	Relative Gains
Political Agenda	(Hyper) Globalization	De-Globalization
Economic Agenda	Expanding Economic Ties	Weaponizing Economic Ties
Political Consequence of Economic Agenda	Undermining LIO *	Undermining GEO **
Dollar's Role in IPE	Global Public Good	Club Good

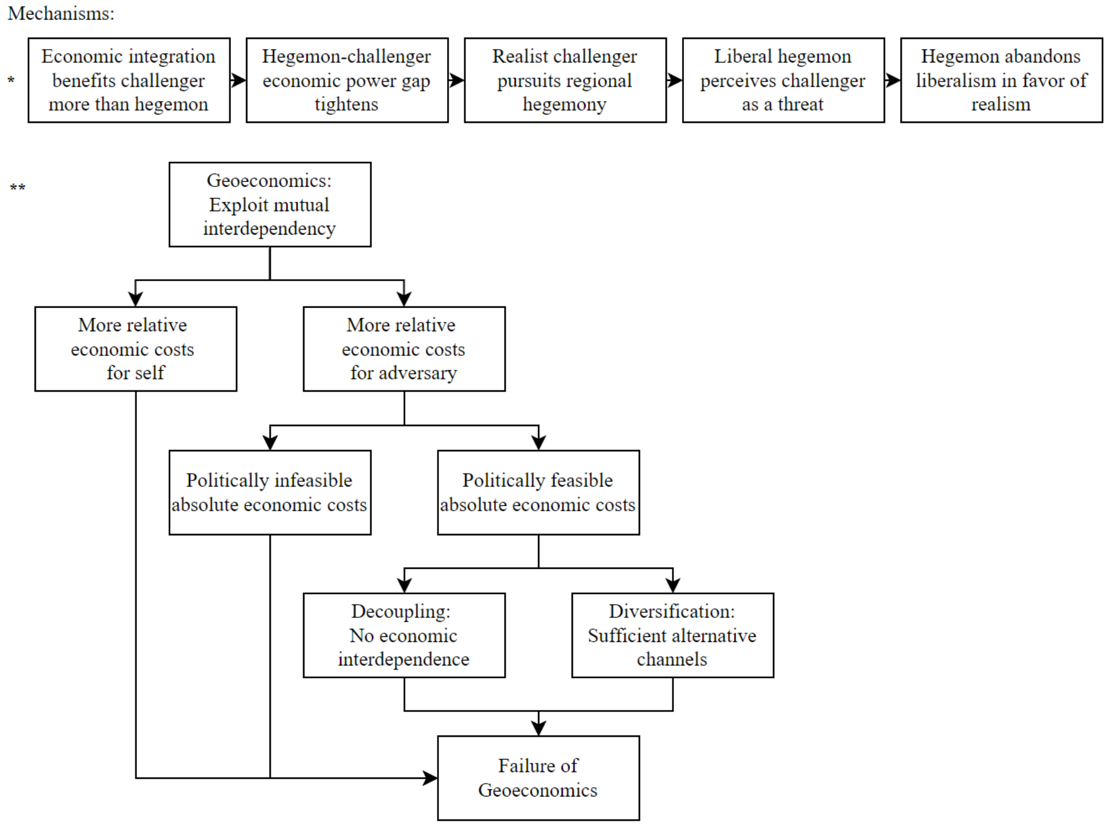

Figure 1: A Summary of the International Political Economy Context

Table 1: A Summary of Currency Geoeconomics Framework

<table>
<tr><th colspan="2">Roles of Int. Currency</th><th colspan="2">Benefits for Issuer</th><th rowspan="2">Geoeconomic Options of Issuer (to Weaponize Benefits)</th><th rowspan="2">Weaponization Requires Interdependence with Adversary?</th><th rowspan="2">Geoeconomic Options of Adversary</th><th rowspan="2">Long-term Geoeconomic Potential</th><th rowspan="2">Lit. Volume</th></tr>
<tr><th>Abstract</th><th>Applied</th><th>Abstract</th><th>Applied</th></tr>
<tr><td>Store of Value</td><td>FX Reserves</td><td rowspan="2">Political Privilege (Network powers, panopticon/ choke point effects)</td><td>Control Financial Assets</td><td>Financial Sanctions (Freeze Assets)</td><td>Yes (Short-term / Transactional Dependence)</td><td rowspan="2">Decouple from Issuer or Diversify Economic Dependencies</td><td>The Least (Easy to Implement, Easy to Counter)</td><td>The Most</td></tr>
<tr><td>Medium of Exchange</td><td>Int. Payment System</td><td>Control Int. Payments</td><td>Financial Sanctions (Block Access to Payment System Infrastructure)</td><td>Yes (Long-term / Infrastructural Dependence)</td><td>In-between (Difficult to Implement, Difficult to Counter)</td><td>A Few</td></tr>
<tr><td>Unit of Account</td><td>Debt Denomination</td><td>Economic Privilege (Provide Resources)</td><td>Run Cheap, Large, and Lengthy Deficits</td><td>Finance Military</td><td>No</td><td>Cannot Prevent (Only can Compete over Lenders via Internationalization of Own Currency)</td><td>The Most (Easy to Implement, Very Difficult to Counter)</td><td>Almost None</td></tr>
</table>

1 THE INTERNATIONAL CURRENCIES FRAMEWORK

What are we talking about when we talk about currency dominance in general or dollar hegemony in particular? This chapter briefly reviews the economics and political science literature to understand international currencies – with a special focus on the U.S. dollar – their importance, their prospects, and their economic and political determinants.

1.1 What is an international currency?

Here I use the definition of an international currency as a currency used outside the issuing country's borders (Gourinchas, Rey, and Sauzet 2019). As a form of money, international currencies serve three classic functions: 1. Medium of exchange 2. Store of value 3. Unit of account. Used by the public and private sectors around the world, these currencies serve six distinct, yet related roles.[1]

Among global currencies in the world, the U.S. dollar is the king. It enjoys unparalleled status in all functions of an international currency:

> "Between a third and a half of global trade is invoiced in dollars… It is involved in nearly 90% of foreign exchange transactions; such is the liquidity of the greenback that if you want to swap euros for Swiss francs, it can be cheaper to trade via dollars than to do so directly. About half of cross-border debt is dollar-denominated. And although the dollar's share of central-bank reserves has fallen over the long term, it still accounts for about 60% of them" (*Economist* 2023b).

Inspired by international relations terminology, Norrlöf (2023a) presents the concept of 'currency polarity' (Norrlöf 2022) with the idea of whether other currencies can balance against "the dollar's full-spectrum dominance" (Norrlöf 2023c), especially as the reserve currency. In addition to the upper hand of the dollar in various domains

[1] For dichotomies of roles, see: (Cohen 1971; Kindlerberger 1981; Kenen 1983; Gourinchas, Rey, and Sauzet 2019). For interconnections of roles, see: (Krugman 1984; Eichengreen, Mehl, and Chitu 2018).

of the global economy, many have paid attention to the outsized role of the dollar relative to the U.S. economy in the world. For instance, the 58.38% share of the greenback in foreign exchange reserves (see Figure 1.1) punches well above the United States' 15.39 % contribution to the world GDP (in PPP terms)(IMF 2023d). Among others, Gopinath (2015) and Boz et al. (2020) report similar trends concerning the invoicing currency for international trade.

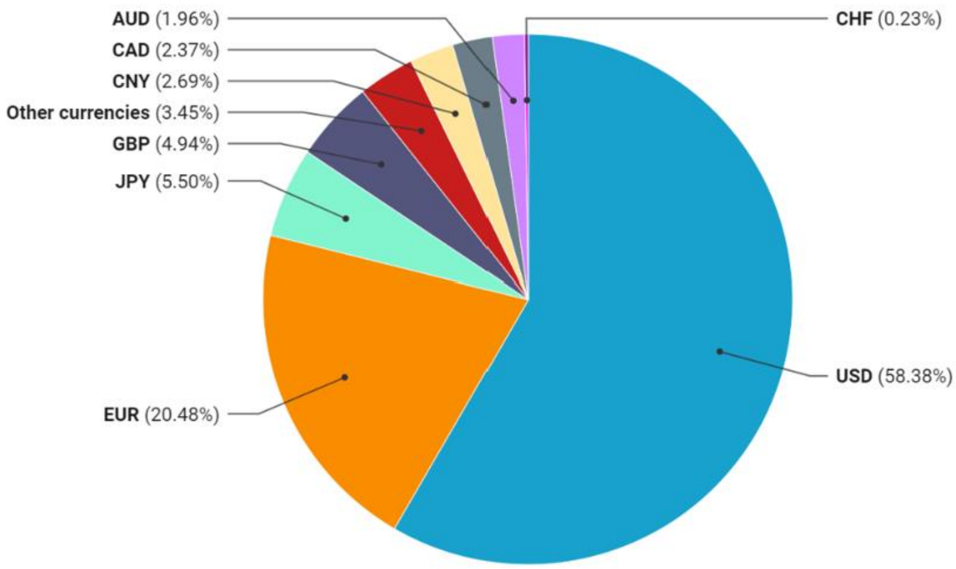

Figure 1.1: Foreign Exchange Reserves by Currency (Q4,2022)
Source: IMF (2023a)

Such disproportionality puzzles those economists who seek to explain the position of the dollar based on the properties of the U.S. economy, such as its share in the global output (*inter alia*, see: (Chinn and Frankel 2007). Lu and Wang (2019) show that calculations based on the GDP, global trade, and debt market size would predict the same share of foreign exchange reserves for the dollar and euro. While as the closest competitor, the euro accounts for only about 20% of central banks' reserves, and far behind, stands the second largest economy of the world – China – with a share of less than 3% (IMF 2023a). This suggests that the currency hierarchy (Strange 1971a; 1971b), at least in the world reserves, has to do with the attributes of the money itself rather than the economic attributes of the issuer (Ito and McCauley 2019).

Politically, the relative decline of the U.S. in the international economy raises questions in the international relations scholarship as well. As the basis of LIO (Oatley 2015), the dollar's prominence has been a "product of and an enabler for continued American international primacy" (Norrlöf and Poast 2020:112). Hence, international political economists are also puzzled about the observed gap between the relative decline in U.S. power and the persistence of the dollar's supremacy (Cohen 2020). This dominance has weathered storms like the collapse of the Bretton Woods system (Gourinchas 2021) and the 2007-08 financial crisis (Cohen and Benney 2014), among other historical episodes reviewed by Oatley (2014). Nevertheless, dollar hegemony faces some challenges that are examined by Norrlöf and Poast (2020). Yet, amongst all, the declining trend of the USD's share in FXR (see Figure 1.2) seems to be the most recurring concern in the literature. Even though, as evident in Figure 1.2, the vacated positions have not been assumed by the traditional global currencies – the euro, yen, and pound – and the renminbi accounts for only 25% of the greenback's loss (Arslanalp, Simpson-Bell, and Eichengreen 2022).

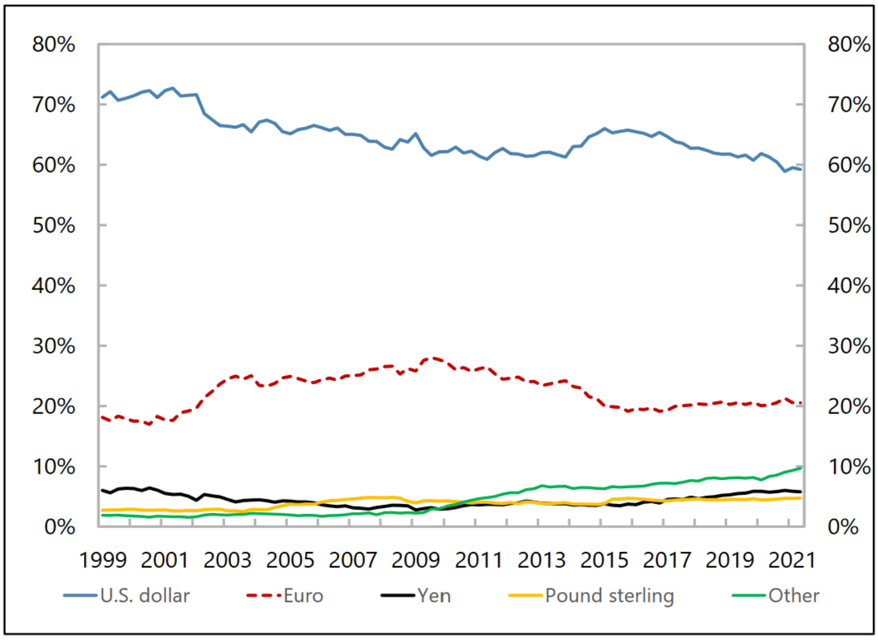

Figure 1.2: Currency Composition of Global Foreign Exchange Reserves (1999-2021)
Source: (Arslanalp, Simpson-Bell, and Eichengreen 2022)

Nevertheless, except for the practical constraint on the data availability, it is not clear why the researchers in academia or the policymakers in the U.S. Congress are fixated on the dollar's share of global reserves. In this research, I argue that the currency dominance in aspects other than the FXR merits more attention from political economists. Even from a mere economic standpoint, at least since the 2007-08 financial crisis, studying international debt issuance – the domain where the dollar has gained in global shares (Eren and Malamud 2022) – can alter our understanding of international currencies and their implications. Especially nowadays when the dollar interest rates are high, a Chinese-led initiative similar to the IMF's Special Drawing Rights basket like the BRICS currency (Greene 2023) might become more than just "funny money" (Eichengreen 2011:7) due to its potential for attracting global support ahead of internationalizing the renminbi.

The focus on the FXR might have misled the existing analyses in various ways. For starters, some experts use the FXR data over short time spans to analyze the impact of different variables such as the sanctions imposed on Russia (Norrlöf 2022) or the debt-ceiling crisis in the U.S. (Gori 2023) on the international appeal of the green back. However, such arguments require strong implicit assumptions about the workings of the central banks around the world. To begin with, they ignore the introduction of credit swap lines between the Federal reserve and many central banks (Federal Reserve Board) that by ensuring access to liquidity reserves upon request, reduces the incentives for hoarding dollar assets.

Moreover, to read into reserves compositions' changes in the short-term assumes active portfolio management by the central bankers. Meanwhile, it is well-understood in the literature that the currency composition of the central bank portfolios is subject to mechanical fluctuations in variables such as exchange rates and interest rates (Arslanalp and Simpson-Bell 2021). Indeed, economists put in considerable effort to distinguish active portfolio diversifications from passive rebalancing and data-related issues (Lim 2006; Arslanalp, Simpson-Bell, and Eichengreen 2022).

In addition, it is crucial to understand the incentives behind active portfolio managements. For instance, diversification away from the dollar into less popular currencies for their financial return on investment (Arslanalp, Simpson-Bell, and Eichengreen 2022) is greatly different from diversifying into physical gold for sanction-proofing purposes (McDowell 2023). Hence, one should study what replaces the dollar in the FXR. Unfortunately, country-level data on the composition of the FXR is scarce, and to make it worse, the literature tends to ignore this ignorance. For one, Norrlöf (2022:11) reports global "diversification away from the dollar… into the renminbi" and other currencies, including the rest of the Big Four – USD, GBP, EUR, and JPY. However, since she is not using the central bank-level data, the shrinkage in the dollar reserves and expansion of the yuan piles does not necessarily mean diversification away from the dollar into the renminbi. Save that diversifying away from the dollar into the Big Four makes little sense, economically (Arslanalp, Simpson-Bell, and Eichengreen 2022) or politically (*Economist* 2022).

Finally, when it comes to the political risk – whether as in McDowell's (2023) particular definition[1] or as broadly understood as the possibility of losing access to one's reserves due to financial sanctions (Weiss 2022; Norrlöf 2022) – the literature usually ignores that the FXR are managed by the central banks and not the government in its political capacity. Hence, those accounts that argue for security reasons of using an international currency – such as Norrlöf 's (2020) "political affinity" or McDowell's

[1] "The potential for a political act to raise the expected costs of using a currency for cross-border transactions or as a store of value" (McDowell 2023:17)

(2023) "diffused benefits" – ignore the ground truth regarding the institutional setups between the central banks and the governments. Such accounts must either assume the void of central bank independence or that the politicians and the central bankers equally perceive and weigh political risks. Neither assumption is trivial.

1.2 Why do dominant currencies matter?

Despite bearing critical consequences for policymaking, surprisingly, it is difficult to explicitly find why currency dominance matters for the literature. Moving past the efficiency and welfare concerns of economists (IMF 2001; Gourinchas 2022), or the provision of the global public good of a stable financial system (Kindleberger 1973), it is all about power for many IPE scholars. The historical implications of a change in the international monetary system for the rise and fall of great powers (Strange 1971a; Kindleberger 1976; Eichengreen 2019a) coupled with the rising concerns about de-dollarization and the relative decline in the global status of the U.S., has invigorated attention to the issue in the field.

General theories linking currency dominance and various understandings of power, among others, exist in the works of Strange (1987a), Gilpin (1987), Norrlöf (2014), and Cohen (2015). Nevertheless, there is no consensus in the scholarship about the magnitude of the effect of dollar dominance on the U.S. power, or previous dominant currencies and their issuer (Cohen 2015; Khanna and Winecoff 2020). In other words, it is important to understand what set of alternatives – such as military capabilities – could enable the U.S. to exert the same amount of power and achieve similar results, had it not possessed the king currency. And how much would that bundle of options cost?

Such counterfactual questions might seem absurd at first glance. However, they shield the debate from over/under-emphasis. For instance, some scholars go as far as arguing that the monetary hegemony constitutes the international order (Khanna and Winecoff 2020); A viewpoint which is rejected by others for capturing the relationship in reverse (Eichengreen 2011; Cohen 2020). On the other side of the spectrum, Cohen (2015) cites major research that concludes the dollar's status has offered little advantages, if any, for the United States. Some even argue that the U.S. would benefit from a less dominant dollar (Eichengreen 2011; Pettis 2023). Cohen (2015) criticizes such studies on the grounds that they fail to consider all the seven costs and benefits he associates with currency dominance. Expectedly, it is difficult to measure factors such as "political leverage" in the first place. Save incorporating all seven in a study and quantifying their relative importance, necessary for weighing total benefits against the sum of all costs.

The literature attributes different benefits for the United States to the dollar's leading position in the international monetary system. In a broad dichotomy, these benefits can be categorized into economic and political dimensions. Starting with the economic advantages, Gourinchas, Rey, and Sauzet (2019) review various accounts of economists while Norrlöf et al. (2020) survey the IPE literature. The common theme of this canon evolves around the famous "exorbitant privilege" term mentioned earlier, in whatever form it is described. The privilege, by and large, is the United States' ability to persistently run huge current account deficits or its lower-than-expected borrowing costs (Gourinchas, Rey, and Sauzet 2019). These two accounts are equivalent since both reflect the global trust in Uncle Sam's repayment capability. Put differently: "Monetary power has two hands— the power to delay adjustment and the power to deflect adjustment costs" (Cohen 2015:239). Oatley (2015) elaborates on how the dollar's global status has contributed to the United States' position as a global superpower by forming cycles of debt-financed military buildup followed by periods of economic boom and financial bust. He argues that the U.S. would have an arduous job to finance its military campaigns had it not been for the dollar's supremacy.

The political advantages of a dominant dollar stem from the central position of the green back that enables the U.S., among other forms of soft power (Kirshner 2008), to apply economic pressure via geoeconomic means, namely financial sanctions (Blackwill and Harris 2016). This source of power, whether understood in terms of Strange's (2004) 'structural power' or 'weaponized interdependence' of Farrell and Newman (2019), "offers the United States a non-military instrument of coercion with which to police international order."[1] Chapter Three explains that while the financial sanctions' functionality does not entirely depend on the dollar itself, their effectiveness is essentially tied to its widespread use. Given the literature's headache on the question of whether sanctions work (Drezner 1999; Nephew 2018; Smeets 2018; Demarais 2022; McDowell 2023), it is hard to measure to what extent they have served the geopolitical interests of the U.S., and how much would it cost to achieve the same results through alternative means of power projection.

With this breakdown of privileges in mind, one finds the literature silent about the links between each dimension of the exorbitant privilege and a currency's share in the global economy. We are used to the charts that show the international currencies' shares of FXR, global trade, and so forth. Yet, nobody has questioned the political emphasis that the literature puts on the global rankings in these areas.[2] As a clarifying example, the U.S. loses its coercive options over a country, say China, as soon as it comes up with an alternative financial system to support its economic transactions. This deduction holds regardless of the share of the dollar in the outstanding global payments.

[1] "Dr. Carla Norrlöf's Statement in Hearing Entitiled: Dollar Dominance: Preserving the U.S. Dollar's Status as the Global Reserve Currency" (2023).
[2] For instance, see the currency hierarchy literature, e.g. Strange (1971a; 1971b).

Similar is the case for the FXR shares. Surprisingly, the dollar's leading position in FXR is unlikely to be lost due to geopolitical concerns (Weiss 2022). Researchers widely use the COFER[1] data on reserves with disregard to the aggregated nature of this dataset which does not contain the country-level information. Using confidential data on the country-level compositions of a large sample of countries provided by the Treasury International Capital (TIC), Weiss (2022) estimates that around 50-60% of all dollar reserves are held by countries with strong geopolitical ties to the U.S.; a share that increases to 75% when any form of military cooperation with the United States are accounted for. Hence, the economic determinants held constant, the dollar will probably keep its majority in the official reserves even under the worst-case geopolitical scenario that some of the largest emerging markets turn their back on the greenback. In light of these findings, we might want to surpass asking whether it matters for the U.S. power if the dollar loses its throne (Kirshner 2008). The more interesting question, I believe, is how valuable the continued reign of the dollar is for the U.S. power.

1.3 Dominance determinants

Understanding why the dollar is so dominant lies at the core of forming expectations about the greenback's future. Thus, a body of literature contends with uncovering the determinants of dollar supremacy. Classic economic factors of the issuing country – such as its share of global GDP and trade, and the depth and liquidity of financial markets – are well-known to be important contributors to a currency's international appeal (Norrlöf and Poast 2020). McDowell (2023) summarizes the works of Helleiner (2008) and Cohen (2012) to mark the most important features of an

[1] "Currency Composition of Official Foreign Exchange Reserve," (IMF 2023a).

international currency, namely, 'confidence' and 'convenience:' It should preserve the invested value and be easy to use.

However, as Chinn and Frankel (2007) convey, the observed gap in America's declining share in the global economy and the unmitigated rule of the dollar challenges the importance of classic factors. More recently, research appreciates the intricate links between various functions of global currencies and the operation of the international financial system. Gourinchas, Rey, and Sauzet (2019) provide an overview of the ongoing research in this area. One of the most insightful takeaways from this literature is that the network effects of the dollar-centered financial system might be overstated (Eichengreen, Mehl, and Chitu 2018; Eren and Malamud 2022). These network effects, also known as 'inertia,' capture the synergies that emerge as the network of a currency users expands: "The dollar is widely used because it has been widely used" (Eichengreen 2011:p126 ; Kindleberger 2013).

Some scholars build upon the potential of network studies to address a wide range of questions in the field, the international currencies among them (Khanna and Winecoff 2020; Winecoff 2020; Winecoff and Young Forthcoming). In this view, the network of the global economy centered around the U.S. and the dollar is believed to be resilient to external shocks, but vulnerable to internal mismanagements by the central node, namely the U.S. policymaking (Khanna and Winecoff 2020). This view is particularly insightful for underscoring the importance of sound macroeconomic policy in the U.S., and also its foreign policy such as avoiding unilateral financial sanctions (Demarais 2022; McDowell 2023). Yet, it disregards the relevance of external factors such as runs on the dollar standard or geopolitical concerns.

Notwithstanding, this is not to suggest that the network effects are not empirically relevant. Indeed, puzzled by the unproportionate popularity of the dollar relative to the euro, Chinn and Frankel (2007) attribute the dominance of the dollar to the incumbency advantages and the self-reinforcing network effects. Later, Truman (2007) found that the lagged share of the dollar in currency composition is the predominant source of variation in the data. Such observations of inertia, as Arslanalp, Simpson-Bell, and Eichengreen (2022) argue, might be indications of lock-in due to network effects. Yet they might arise out of behavioral biases or bureaucratic procedures. For instance, they cite Chiţu, Gomes, and Pauli (2019) who report an every three-year procedure of portfolio adjustment in the European Central Bank. On top of that, Eichengreen (2005) questions the network effects explanation for the observed inertia in the data by arguing that it makes little sense for central banks to hold a widely held currency when the whole point of FXR is diversification. This calls for thoughtful interpretations of the inertia when predicting future reserve shares (Posen 2008).

More generally, the question of determinants of the dominant currency should be investigated both retrospectively and prospectively. While history can provide insights for going forward, it should not be assumed that the future necessarily mirrors the past. Eichengreen, Mehl, and Chitu (2018) argue that while currency multipolarity has been around for many years before the dollar standard system, the special situation at the beginning of the 20th century, including the lack of competitors, led to the dominance of the dollar. Nonetheless, with the advent of new financial technologies and developments of the more liquid financial markets worldwide (Arslanalp, Simpson-Bell, and Eichengreen 2022) – that introduce competition for the dollar – the global landscape of international currencies is subject to rapid changes in the future.

The emergence of viable alternatives for the dollar in the yen and later the euro before the turn of the century compelled some scholars to expect that the days of the dollar are counted (Oatley 2014). In their famous piece, Chinn and Frankel (2007) boldly predicted that the euro will surpass the dollar as the leading global currency at some point before I wrote these lines. However, the passage of time proved otherwise. Euro's share of foreign exchange reserves changed little from its initial level upon its birth, and regarding global trade, it remained mostly a regional currency for trade involving the EU area (Arslanalp, Simpson-Bell, and Eichengreen 2022). And at least since the 2007-8 financial crisis, similar heyday predictions have been made regarding the yuan's prospects (McDowell 2023).

In a response paper to Chinn and Frankel (2007), Posen (2008) explains "why the euro will not rival the dollar." He argues that the position of the dollar, especially as the leading reserve currency, has to do with some supportive political factors that the euro cannot afford, in addition to the economic factors that the EU can provide for its currency just as well as the U.S. He shows that the choice of the peg currency is an important determinant of the reserve currency – accounting for 56% of the variation in Arslanalp, Simpson-Bell, and Eichengreen's (2022) study. Li (2003) emphasizes the correlation between the U.S. direct military presence in countries and their choice of peg currency. Recognizing the relevance of such political factors combined with the EU's inability or unwillingness to assume a similar role in extra-territorial security provision, Posen concludes that the euro, no matter how sound its economics, can never dethrone the dollar.

IPE specialists have been familiar with the political determinants of dollar supremacy. Norrlöf (2020) summarizes this literature to conclude that military power, quid pro quo themes, and political affinity are the three political forces behind dollar hegemony. Except for the military power when it is meant as the U.S.' debt collection muscle, quid pro quo themes such as the U.S.-Saudi dollar for oil deal (Croteau and Poast 2020) or the U.S.-Germany "offset agreement" (Zimmermann 2002), are called direct benefits in McDowell's (2023:25) words. “diffuse gains,” in contrast, are the other indirect political benefits of holding the dollar (McDowell 2023:26). Direct benefits when contributing to a currency’s international appeal, make it a “negotiated currency” for Strange (1971b; 1971a). Meanwhile, given the United States’ hegemony, the diffused benefits of using the dollar provide the greenback with the top currency status in her typology.

Many approve that the political factors should not be mistaken for the economic fundamentals as the chief determinant of currency internationalization (Cohen 2015; McDowell 2023). Nonetheless, I mentioned that the recent tide of dollar dominance debate is concerned with the effects of international politics developments and especially the consequences of the U.S. foreign policy on the dollar’s status. Thus, some scholars have shifted focus to this question. McDowell (2023:25) finds that up until recently, the literature has primarily considered on a “traditional view” in which the U.S. foreign policy can promote and sustain the dollar’s preponderance. His “new perspective,” in contrast, looks for ways in which Washington can harm its currency’s prospects. While he recognizes the financial sanctions to have jeopardized the dollar’s position, he is cautious not to claim this factor as the primary reason for, but a mere contributor to de-dollarization.

Alike Demarais (2022), McDowell warns the White House that this might have been “the moment that the dollar's hegemony and its status as a reserve currency began to falter” (Zakaria 2023). Conversely, Norrlöf (2023) doesn’t see financial sanctions as likely to be the tipping point for dollar dominance. Such disagreements, to some part, stem from the fact that our understanding of the extent of the significance of the political factors, and more importantly, the magnitude of their effect relative to the economic factors are still wanting (Norrlöf and Poast 2020; Norrlöf 2020).

1.4 The future of international currencies

Despite implying dollar's erosion where it matters for 'political risks' (McDowell 2023) and its solidification on other fronts, predicting the future of dollar dominance is not the aim of this study. However, the noticeable body of works on this issue has new insights for understanding the functioning of global currencies and warrants attention. Two widely held positions can be spotted in the literature when it comes to predicting the dollar's future: 1. Continued hegemony 2. Possible multipolarity. Respectively, Eichengreen (2019) calls these two positions the Harvard view and the Berkeley view according to the academic affiliation of their advocators. He explains that based on the empirical studies that profess complicated interconnections between different roles of the dollar in the international economy, Harvard people rule out the possibility of the dollar losing its leading position.

On the contrary, the Berkeley economists argue that for the best part of history, currency multipolarity has been the norm, and theoretical challenges toward maintaining dollar dominance – such as the emerging markets and the consequent new Triffin dilemma (Gourinchas and Rey 2007) – can make a transition scenario likely (Eichengreen 2019b; Gourinchas 2022). A similar dichotomy can be found among IPE scholars (Norrlöf et al. 2020), with the subtle difference that those who argue for the currency multipolarity, see the transition as inevitable (Cohen 2020) – and not just plausible. The imminence stems from either the relative decline of the U.S. power or its domestic problems such as the debt overhang (McDowell 2023).

Multipolarists usually see the transition as gradual: "The threat is not a wolf at the door but more like termites in the woodwork" (Cohen 2020). Yet some economists don't rule out the possibility of an abrupt transition (Eichengreen 2011; Eren and Malamud 2022). Triffin (1961) correctly anticipated that at some point, a run on the dollar could terminate the Bretton Woods system, and it did (Winecoff 2014; Farhi and Maggiori 2018). To the disappointment of the French as a staunch challenger of the system (Kirshner 1995), however, the collapse of the Bretton Woods did not erode the dollar's prominence, but quite the reverse, reinforced it (Gourinchas, Rey, and Sauzet 2019). This lent support to the "minority view" which predicts that the financial system would remain stable under the United States acting as a 'world banker' (Despres, Kindleberger, and Salant 1966). Yet Farhi and Maggiori (2018) show that even under this view, the runs on the dollar could still occur, and with possible grave consequences.

Oatley (2014) offers another dichotomy of the dollar's prospects in instrumentalism versus geopolitic outlooks. He explains that the instrumentalism view ties the future of the dollar to its usefulness for advancing the central objectives of other governments. While the more classic geopolitic perspective expects the hegemony of the dollar and of the U.S. to go hand in hand. In this sense, this viewpoint would share the puzzle of the divergence between the dollar's status and that of the United States which I discussed earlier. Central to both accounts, nonetheless, is the unraveling of the U.S. power (Oatley 2014).

The question of succession is closely tied to the future of the dollar. Scholars usually only look at the euro and the yuan – including their digital forms – as serious contenders to the greenback (*inter alia*, see Eichengreen 2011; Cohen 2015; Demarais 2022; McDowell 2023). Meanwhile, research shows that while the yuan is gaining ground, non-traditional reserve currencies – including the Australian dollar, Canadian dollar, Korean won, Singapore dollar, and Swedish krona – account for 75% of dollar erosion in FXR (Arslanalp, Simpson-Bell, and Eichengreen 2022). This is particularly important for disentangling the dollar dominance debate from the rise of China, and a more autonomous EU for that matter (Demarais 2022; McDowell 2023). The dollar's fall and the rise of alternatives are more complicated than a simple zero-sum game of market shares.

To conclude, international currencies topped by the U.S. dollar are extremely complicated phenomena that have not received commensurate diligence in the IPE literature given their political significance. Theoretical gaps in the politics of global currencies in the statecraft, inattention to monetary economics, and the scarcity of disaggregated data on currency compositions might have misled the scholarship. The next chapter keeps an eye on these challenges to depict an international political economy landscape in which, unfolds my theory of currency geoeconomics.

2 THE GEOECONOMICS FRAMEWORK

Chapter One recaps the rationale of monetary economics that international monetary relations are tied to the flow of the global international economy. This chapter investigates the expected direction of the international economy in light of recent transitions in the systemic-level world order. Hence, it sets up the context surrounding our discussion of currency geoeconomics. A review of the liberal international order and its controversial demise opens this chapter. I continue by introducing the 'geoeconomics order' as the supplant realist international order. I review the accounts on the states' geoeconomic behaviors as the empirical hunches to conceptualize this order at a higher level of abstraction. From this standpoint, two perspectives for the global economy emerge that will be discussed in depth. I close by explaining why both scenarios result in the demise of the geoeconomic order.

1.1 The Liberal International Order

There is no consensus that the liberal international order is coming or has come to an end (Among contesters, see: Khanna and Winecoff 2020; Brooks and Wohlforth 2023). Nonetheless, due to the scope constraints, I side-step that debate by taking a well-established position, as given, and investigating its implications. The same is true for the systemic order that supplants the LIO, where I follow the scholars who believe in a "geoeconomic order" (Roberts, Choer Moraes, and Ferguson 2019).

I use the term liberal international order as conceptualized by Mearsheimer (2019). As one of the most renowned scholars of realism, he provides a parsimonious account of the LIO that offers analytical clarity and can be fruitfully combined with the currencies debate reviewed earlier and the realist order that follows the LIO. By and large, his definition of LIO is consistent with other – including liberal – accounts in the literature (*Inter alia*, see Acharya 2017; Ikenberry 2018; Kornprobst and Paul 2021).

For Mearsheimer (2019), LIO is marked by the following characteristics: 1. It is a unipolar order 2. The hegemon (USA) has a liberal ideology, pursuing three main goals: i) To spread democracy around the world ii) To pursue utmost economic integration iii) To develop a network of inclusive international organizations as the global rules. He uses the term order, to refer to a set of international institutions that govern different aspects of global affairs. The internationality of the order captures the fact that all of the great powers (in this case, only the U.S. as the sole pole of the system) are included in this order. The opposite would be a bounded order. In the Cold War era, the U.S. and the U.S.S.R. as the two great powers of a bipolar system, managed their bounded order in their spheres of influence. The third aspect of an order, in Mearsheimer's terminology, is the breadth and depth of the order. It captures the extent to which the order influences the behavior of member-states. In this regard, LIO is described as a thick international order. In contrast, the Cold War era featured two thick bounded orders of the West and the East and a thin international order with little influence over countries' behaviors.

In varying degrees, many have argued for the (ongoing or complete) end of LIO as it was once known (Acharya 2017; Ikenberry 2018). Although multiple accounts have investigated the roots of its fall that will not be discussed here. However, Mearsheimer argues not only LIO has already ceased around 2017, but "that order was destined to fail from the start, as it contained the seeds of its own destruction" (Mearsheimer 2019:7). He mentions three forces at work to undermine the order: 1. Nationalism outside liberal democracies 2. Nationalism inside liberal democracies themselves 3. The consequences of hyper-globalization. Theses consequences consist of two components. First, the economic and political problems in the West due to hyper-globalization. Second, the rise of China which is to conclude the "unipolar moment" (Krauthammer 1990) by reintroducing the balance of power politics back into the equation (Mearsheimer 2019a). Mearsheimer (2018) provides a comprehensive account of the first two variants of nationalism, and among others, Rodrik has extensively written on the problems of hyper-globalization (see Rodrik 1998; 2011).

Mearsheimer holds that even absent the rise of China and the resurgence of Russia, LIO would cease to exist for its "intrinsic flaws" (Mearsheimer 2019:42). Yet, the inverse argument also merits attention: Even absent the LIO's intrinsic flaws, the rise of a challenger, be it China or else, would wrap up the order by terminating unipolarity. The logic of convergence in the economic growth theory – the dominant school of economic thought in the U.S. (Elliott Armijo and Echeverri-Gent 2014) – suggests that other countries, especially emerging markets would have grown faster than the U.S. (Eichengreen 2019b). This closes the gap between the hegemon and the potential challengers, at least on the economic front, which is the basis of geopolitical power in realism thought (Mearsheimer 2019b). While Washington thought by fostering China's economic growth through its integration into the global economy, it would turn into a democracy and a "responsible stakeholder" (NCUSCR 2005), the realism logic dictates otherwise (Mearsheimer 2021). Even if the challenger's rise is peaceful (Mearsheimer 2007), the "economic realism" thought that dominates the global South would call for challenging the inequalities in the international economy that works to the benefit of the hegemon (Elliott Armijo and Echeverri-Gent 2014).

This contests the opinion of Wang (2020) who holds that China is only challenging the U.S. but not the liberal order. However, even if one does not agree with Mearsheimer (2019b) on unipolarity's necessity for the LIO – which is inevitably challenged by the rise of China as the second great power – it would be hard to accept that Beijing only wants to challenge the U.S. without rewriting the rules of the rule-based liberal order in its favor. This would essentially change the nature of the LIO to the point that it would be more difficult to recognize it as the same liberal order.

2.1 Geoeconomics and the Geoeconomic Order

One way or another, "the end of the end of history"[1] is here in the 2020s (Milan, Dixon, and Liu 2022). Many have been keeping an eye on the states' behaviors to decipher the replacing order's characteristics. A deep-rooted observation in the literature is the abundance and importance of geoeconomic initiatives (Wigell, Scholvin, and Aaltola 2019; Farrell and Newman 2019; Meunier and Nicolaidis 2019; Gertz and Evers 2020; Aggarwal and Reddie 2021; Milan, Dixon, and Liu 2022). The extensive use of geoeconomic tools as a 'first resort' by rising powers and emerging economies (Blackwill and Harris 2016; Wigell 2016), as well as being the go-to option of great powers such as the United States[2] (Drezner 2021), has led some scholars to see the world in transition to a "geoeconomic order" (Roberts, Choer Moraes, and Ferguson 2019). In this definition, the geoeconomic order is a 'thick international order' in Mearsheimer's (2019b) terminology, since it contains all the great powers of the system, and heavily influences their conduct.

One could devote an entire thesis to defining the term 'geoeconomics,' whether understood by its Luttwakian definition of the "logic of conflict and grammar of commerce" (Luttwak 1990) or other definitions that allow for cooperation/competition

[1] Hochuli, A., Hoare, G., & Cunliffe, P. (2021). The end of the end of history. Zero Books. In reflection to the Fukuyama's famous piece: Fukuyama, F. (1992). The end of history and the last man. Free Press.
[2] Blackwill and Harris (2016) criticize the US for its moving away from its historical habit of using geoeconomic means other than economic sanctions. However, the US widely uses this single geoeconomic tool, to the point that about 25% percent of nations on earth are under US sanctions (McDowell 2023).

mixes (Babic´, Dixon, and Liu 2022). However, for this piece, it suffices to take stock of the existing consensus in this literature, namely that exploiting mutual economic interdependencies is the central idea of geoeconomics (Kim 2019). Detailed accounts of the various definitions of the term and their evolvements can be found, *inter alia*, in Luttwak (1990), Blackwill and Harris (2016), Scholvin and Wigell (2018), Moisio (2019), and Milan, Dixon, and Liu (2022). Although not all the geoeconomic means enumerated in the literature require mutual interdependence, such as cyber and foreign aid (Blackwill and Harris 2016), omitting them does not obscure my analysis.

The rise of the geoeconomic order after the LIO, unlike previous episodes of global rivalries that were dominated by geopolitical competitions (Milan, Dixon, and Liu 2022), should come as no surprise. The liberal economic integration agenda of the LIO, promoted deep worldwide economic integration, increasing economic interdependencies by definition. Further, since mutual interdependence skyrocketed under the LIO's reign, the use of geoeconomic means aimed at exploiting these connections is most potent, and thus, more appealing to the politicians than other means with high economic and political costs, say military confrontation.

For example, the potential of sanctions as a policy that keeps face but is not too committal and costly is what made them very popular with U.S. politicians (Drezner 2021). Expressing solidarity with Ukraine in the wake of Russia's invasion, without going into the trouble of a direct armed conflict, is one of the reasons that Demarais (2022) sees the Western sanctions on Russia to have somewhat achieved their intended goal. Interestingly, specialists believe that in a much-anticipated case of a major Taiwan crisis, the G-7 will likely impose harsh sanctions on China (Vest and Kratz 2023), though even the most severe sanctions will have little effect on the unraveling of the war (*Economist* 2023a).

However, geoeconomics is a branch of the realism school of international relations (Scholvin and Wigell 2018), where coercive actions invite commensurate reciprocations. Mutual reciprocations can form a cycle that can go on for a long time. For instance, Fontaine (2023) provides a short review of U.S.-China countermeasures on various issues, including semiconductors, while a comprehensive coverage of the semiconductors Cold War can be found in Miller (2022). On trade, up-to-date timelines of the most important counter-measures are presented in Bown and Kolb (2023) and Bown (2023b).

These geoeconomic measures cut economic ties among nations, both in direct and indirect ways. Directly, it takes place on the economic fronts where the conflict is unraveling (in the “grammar of commerce” Luttwak 1990) between the involved states. Indirectly, it can spread to other potential conflict zones and pull in third parties who are not currently involved in the dispute. Retaliatory measures on one subject can occur in an entirely different area. For instance, a CEO’s tweet supporting pro-democracy rallies in Hong Kong can cause China’s termination of sponsorship and broadcasting arrangements with the NBA (Tusikov 2021). Deployment of THAAD missiles in South Korea can be met with tourism restrictions and the removal of Korean series from China’s internet (Fontaine 2023). Moldova’s proclivity to cooperate with the EU invokes Russia’s ban of Moldovan wine (Blackwill and Harris 2016), or the U.S.’ trade war on steel and aluminum is responded to by retaliatory tariffs on agriculture, Harley Davidson motorcycles and blue jeans (Bown and Kolb 2023). Reciprocations can be surprising, as these episodes suggest.

These seemingly incongruence responses stem from the necessity of the states to respond in kind to others’ actions while minimizing the effects of their geoeconomic practices on their own economy. Further, these counter-measures should be strong enough to save face in the international sphere, but not too harsh to escalate the economic war beyond control. In addition, research suggests that electoral considerations, such as hitting back where it could hurt Trump's prospects the most, might be at play when countries choose their response (Fetzer and Schwarz 2021).

The direct effects of the geoeconomic measure plus the indirect effects of the anticipated risks of reciprocation on other fronts, coupled with fears of inadvertently getting caught in the cross-fire of great powers' disputes, provide incentives for governments and private sectors to take preemptive measures. For example, while few BRICS members directly face the risks of sanctions, many are seeking alternative avenues of transaction besides the dollar (Liu and Papa 2022).

Table 2.1 breaks down the above risks. It remains for future empirical research to fill out each cell with the candidate industries. For instance, Bown (2022) reports where the U.S.-China decoupling is taking place: The U.S. imports from China in industries like semi-conductors, IT hardware, and consumer electronics with a high strategic priority that were targeted by the 25% tariff rates have shown up to 60% decline in comparison to the pre-trade-war era. Meanwhile, industries hit with lower tariffs show mixed signs of decoupling. Interestingly, U.S. imports in sections enjoying no import tariffs, such as consumer goods during the Christmas shopping season, have surged since (Bown 2022).

Table 2.1: A Breakdown of Geoeconomic Risks by Industries and Agents

	Involved agents	**Sideliners**
War zones	Highest risk	Medium risk
Potential future fronts	Medium risk	Low risk

Employing a continuous scale instead of the dichotomy in Table 2.1 increases analytical resolution. Gourinchas (2022) uses the metaphor of an earthquake to convey that the economic effects of the Ukraine war on others are proportional to their distance to the conflict's locus. A similar metaphor can be used here, with the hypocenter of the earthquake being located in the industry space instead of geographic zones.

Yet another critical dimension that can be added to this matrix is the capital mobility of transnational firms. Infrastructures, because of their huge investment costs, and the economies of scale provided by network effects, when put in place are hard to replace or even parallel. That's one of the reasons for the importance of gaining incumbency advantages in infrastructures such as the Belt and Road Initiative (BRI) and communications networks for China in establishing itself as a superpower which raises national security concerns for the West (Mohan and Tan-Mullins 2019; Friis and Lysne 2021; Beeson and Crawford 2023).

Moreover, different infrastructures require sets of standards and regulatory systems that are not necessarily compatible with each other. Hence, it has been crucial for China to increase its footprint in developing international technical standards (Demarais 2022). Additionally, these infrastructures such as the BRI's digital Silk Road initiative, are accompanied by cheap complementary Chinese technology and services that come to dominate host countries' high-tech sectors, without them consciously perceiving Beijing's influence (Blackwill and Harris 2016). Henceforth, the infrastructures are the fields where geoeconomic practices are the most potent, and thus most probably subject to preemptive prudential measures by countries.

2.2 The prospects of the Geoeconomic Order

We can think about the spread pieces of geoeconomic behaviors reviewed above at a higher level of abstraction to get a clear sense of what we can expect in the future.

Mearsheimer (2019b) anticipates the post-liberal order to consist of two thick bounded realist orders, led by the U.S. and China as the two great powers of the system, and a thin realist international order that sees to the efficient operation of the global economy. He distinguishes this setup from the Cold War era due to the thickness of the international order that incorporates both great powers. While the U.S. and China will mainly compete on the security grounds, he holds, this security competition is unlikely to significantly murk their economic relationship. This is because of the huge economic ties in place today between these two superpowers and their peripheries, with mutual benefits larger than to be given up. The numerous historical accounts of trade between enemies in wartime, as reviewed by Levy and Barbieri (2004), bring Mearsheimer to the conclusion that security competition, a less intense form of conflict, will not disrupt the world trade's flow.

While Mearsheimer's argument captures the realist nature of the geoeconomic order (Luttwak 1990; Scholvin and Wigell 2018), it misses the crucial point of geoeconomics literature. In this age of "unwar and unpeace" (Leonard 2021:3), economic relations do not happen despite the war, but they are the very battlefield. Where deglobalization is occurring by the very means of globalization itself – international connectivity (Leonard 2021) – doing business is war by means of economic weapons.[1]

In this economic warfare, two possibilities are imaginable based on the geoeconomic measures' absolute costs' magnitude. Firstly, some options might not be politically feasible. The realist logic of relative gains in geoeconomics (Scholvin and Wigell 2018) is about exploiting mutual interdependencies, where both sides lose in

[1] Blackwill, Robert D., and Jennifer M. Harris. *War by other means: Geoeconomics and statecraft*. Harvard University Press, 2016, and Mulder, Nicholas. *The economic weapon: The rise of sanctions as a tool of modern war*. Yale University Press, 2022.

absolute terms but the enemy loses relatively more (Kim 2019). However, from a political economy perspective, the absolute economic loss for self might simply be unbearable to make a geoeconomic intervention a politically feasible option. Previous episodes from the U.S.-China trade war (Bown 2022) or the immunity of Russian gas from sanctions in the aftermath of the Ukraine crisis (European Parliament 2023) are some examples. Experts predict a similar outcome for the possibility of sanctioning China in the case of a Taiwan crisis (Vest and Kratz 2023; *Economist* 2023a). This bears resemblance to going nuclear in security studies: one might win a nuclear war, but it will usually not be worth the costs. So does Mearsheimer (2019b) conclude that U.S.-China trade is too valuable to part with.

Secondly, if the absolute costs are affordable for states, then two scenarios could arise following the use of geoeconomic means: fragmentation or diversification. The fragmentation of the global economy is the outcome of countries decoupling from each other.[1] Decoupling captures the case where the two sides cut economic ties. This is gradually happening between the United States and China (Demarais 2022; Bown 2023a; Bown and Wang 2023), or more abruptly, between the West and Russia (Gourinchas 2022). Given that the U.S.-China conflict is ultimately an inevitable power dispute over hegemony (Mearsheimer 2021), some scholars believe that sooner or later countries have to side with one of the two comprehensive political-economic camps of the U.S. or China (Mearsheimer 2019a; Fontaine 2023). This would entail "fragmenting the global economy into distinct economic blocs with different ideologies, political systems, technology standards, cross border payment and trade systems, and reserve currencies" (Gourinchas 2022:10).

[1] Despite this minor difference, for simplicity, I use fragmentation and decoupling interchangeably.

Beijing is preparing itself for this worst-case scenario regardless of the U.S.' course of action (Demarais 2022). Likewise, on the other side of the Pacific, some criticize the U.S.' strategy of "small yard, high fence" (White House 2023) or Europe's "de-risking" (European Commission 2023) for being too weak of a response. They make "the case for a hard break with China" (Cass and Rodriguez 2023) while clarifying for the U.S. allies that they should follow suit (Fontaine 2023). Nonetheless, from a geoeconomic standpoint, geoeconomic means lose their potential in a decoupling scenario when there are no mutual interdependencies. Among others, this is why Demarais (2022) warns about sanctions that work too well and cause decoupling.

Diversification is the other plausible scenario. Nobody likes to be forced to choose between the U.S. and China for security and economic gains. Many want to sit on the sideline and keep doing business with both camps: simply put, to have their cake and eat it, too (Fontaine 2023). From the economics' perspective, inefficiency rules out this option. Economically, it makes little sense to have two sets of infrastructure, especially wherever economic logic dictates a natural monopoly. Suppose people have to carry two cell phones to be able to connect to two different 5G networks supported by Western or Chinese telecommunications service providers. However, such arguments overlook the fact that GEO, marked by an increased presence of state capitalism (Gertz and Evers 2020), puts less emphasis on efficiency and economic rationale when the strategic objectives of states are at stake. In other words, the true calculus of the costs and benefits in geoeconomics derives from comparing the total costs of an economic means to achieve a strategic goal to the next best (non-economic) option (Blackwill and Harris 2016).

To elaborate more, I borrow from Taleb's (2012) notion of anti-fragility. He explicates that some mechanisms – like humans having two kidneys while one can live with just one – are not designed with efficiency concerns in mind, but to increase resilience by enabling the system to stomach unexpected disasters. Likewise, public and private actors might want to develop parallel mechanisms to safeguard their interests from the economic coercion of superpowers. Choer and Wigell (2022:44) call such behaviors in the corporate sector "one company, two systems." They review studies that show how firms try to adapt themselves to live in the geoeconomic gap between the two sides. Demarais (2022) and McDowell (2023) reveal how states try to circumvent the U.S. sanctions by developing alternative payment systems, such as China's Cross-Border Interbank Payment System (CIPS) or the EU's Instrument in Support of Trade Exchanges (INSTEX). In the geoeconomics logic, it matters not if these vehicles are far from the efficiency levels of their American counterparts; "what matters is it's there" (*Economist* 2020).

Another idea of Taleb (2012) also merits attention here: A collection of fragile components can make anti-fragile systems. The equivalent thought in geoeconomics on the corporate level is that while geoeconomic tensions can impose serious risks to the global supply chains, just as more broad geopolitical tensions do (Gourinchas 2022), firms might want to make sure that the supply chains, overall, are resilient to the failure of single nodes. Khanna, Morales, and Pandalai-Nayar (2022) find that surprisingly, more complicated supply chains in India were more resilient to the COVID-19 lockdown shocks than those with simpler economic activities. They conclude that precisely because of the firms' awareness of the vulnerability of the complex chains to the unanticipated disruption in any of the links, they extensively invested in making sure that there are enough capabilities and alternatives along the chain to keep the process flowing, should some links go down. Similarly in the statecraft, as captured best by sanctions literature, lies the impression that sanctions are a double-edged sword.

While sanctions impose pain on their target (Nephew 2018), they have a ‘use it *AND* lose it’ characteristic: they encourage the victims, as well as the global observers, to take note and develop alternative channels (Smeets 2018; Demarais 2022).

Figure 2.1 depicts the imaginable scenarios following the use of geoeconomics in the long term. In addition to the empirical pieces of evidence cited above, the overarching characteristics of the fragmentation and diversification scenarios can also be seen in National Intelligence Council (2021) under the names of “Separate Silos” and “Competitive Coexistence,” respectively. They are among five non-mutually exclusive scenarios that the U.S. intelligence services and policymakers expect for the world in 2040.

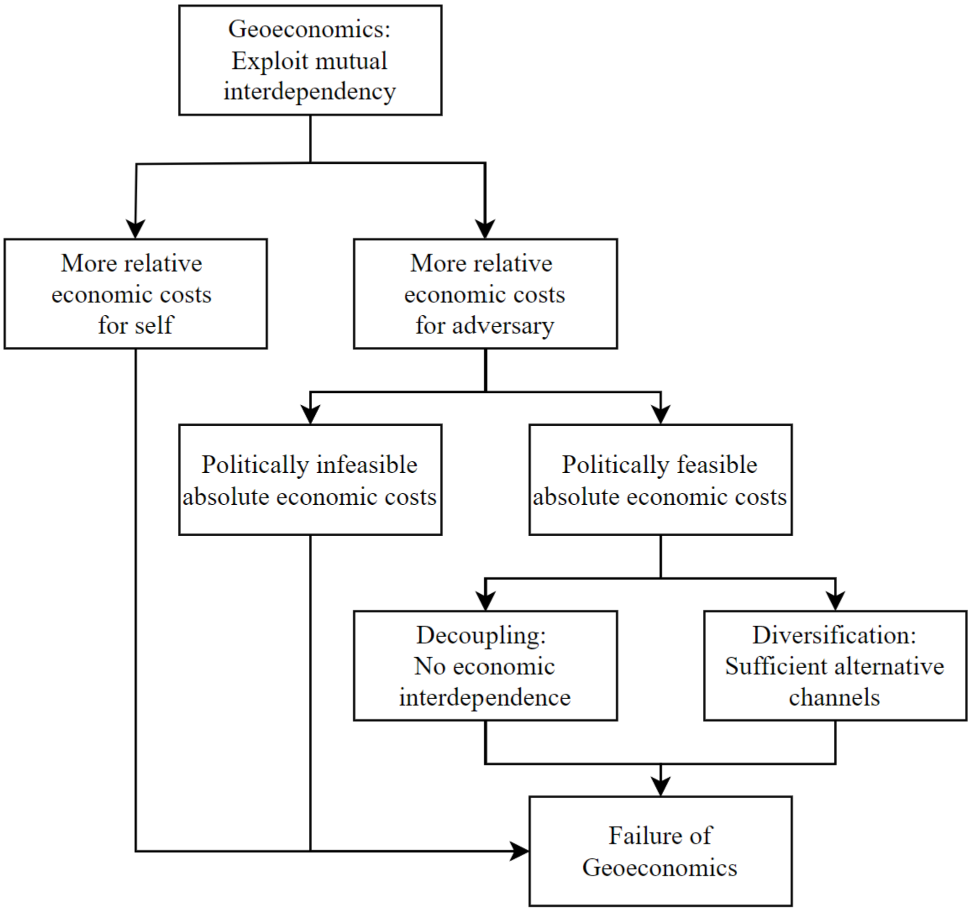

Figure 2.1: The Long-Term Scenarios for Using Geoeconomics

Therefore, alike LIO that contained the seeds of its own destruction (Mearsheimer 2019b), a geoeconomic order is eventually doomed to fail because of its self-destructive incentive mechanisms. Under both possibilities for the distribution of the absolute economic costs of using the geoeconomic tools, and under both instances where these means are politically feasible, they will lose their effectiveness over the long run. This happens either through the non-existence of the requisite economic ties between the two involved parties or because of the existence of sufficient alternatives. This suggests that "the economic weapons … are not just double-edged. They may also be redundant in the only scenario in which they are feasible" (*Economist* 2023a).

To conclude, the geoeconomic order is a very special order that was made possible by the rare occurrence of LIO (Mearsheimer 2019a), and similarly, shares its self-destructive nature. This implies that at least for great power politics, the foreign policy toolbox will once again be stuffed with classic geopolitical instruments. For future research, Table 2.2 summarizes the economic aspect of the presented causal mechanism from the rise of LIO to the demise of the geoeconomic order in the first scenario (decoupling) to be empirically tested via the process-tracing method (Beach and Pedersen 2019). A similar process can be formulated for the diversification scenario. Chapter Three applies these theoretical expectations for the global economy's outlook to the international currencies debate and investigates the implications.

Table 2.2: A Summary of the Decoupling Scenario in A Process Tracing Design[1]

Cause	Causal Steps									Outcome
The rise of LIO	Hegemon promotes hyper-globalization	Hegemon-challenger economic gap tightens	Challenger pursues regional hegemony	Hegemon perceives the challenger as a threat	Hegemon abandons the liberal logic in favor of realism	Hegemon adopts geoeconomic means to contain the challenger	Cycle(s) of mutual reciprocation	Developing intra-block economic schemes	Inter-block economic decoupling	The demise of GEO (Decoupling scenario)
Observable Manifestations	1. Promotion of economic IOs. 2. Facilitating adoption of new member states to economic IOs 3. Promoting globalization in public speeches	Reflection in: 1. Economic indicators (GDP, trade, R&D, etc.) from credible sources such as IMF 2. Academic literature 3. Policy reports of think-tanks	1. Increasing military expenditures 2. More aggressive foreign policy toward neighbors 3. Pushing other major powers out of their own region	Reflections in: 1. National security documents 2. Public announcements of heads of states / department of state / foreign affairs 3. Elite interviews 4. Policy reports of think-tanks 5. Media 6. Academia	1. Increased share of realism and critiques of liberalism in political discourse 2. Officials' speeches on the necessity of containing challenger 3. Elite interview	Evidence for usage of any geoeconomic means such as: imposing sanctions, exploiting choke-points, etc.	1. National security reports and strategies 2. Official statements blaming the other side 3. Media reports 4. Third-country officials expressing concerns about escalations	1. Joint statements by officials on developing projects 2. Policy proposals/evaluations by think tanks, academia, and industry 3. Call for policy papers / dual-use technology development projects by the government	1. Reduction in mutual currency reserves 2. Revising trade contracts 3. Increasing tariffs and trade barriers	-
Test Strength*	(All) SW	1. DD 2, 3. SG	1. HT 2. SG 3. DD	1. DD 2, 3. SG 4, 5, 6. SW	1. SW 2, 3. SG	Each one is SW, but DD to have at least one	1. DD Others: SW	1. SG 2, 3. SW	Each one is SW, but DD to have at least one	-

* SW: Straw in the wind, HT: Hoop test, SG: Smoking gun, DD: Doubly decisive (Beach and Pedersen 2019).

[1] Adopted from my previous papers at Central European University.

3 GEOECONOMICS OF INTERNATIONAL CURRENCIES

Having investigated the systemic-level shifts in the global political landscape in Chapter Two, this chapter maps those political shifts to the international currencies debate. I open with a short review of how the shift in the global order affects the dollar as the most relevant international currency in its various roles. Next, I focus on the function of international payment and explain how the world has lost a valuable public good in the dollar-based payment system as a result of the denoted order shift. These two sections provide a straightforward conclusion on how to assess and rank the potential of geoeconomics in various functions of international currencies, by which I close this chapter.

3.1 The dollar under LIO and GEO

Economic integration during LIO, also known as (hyper)globalization, is a crucial pillar of the LIO in almost all accounts. An interconnected world maximizes the absolute gains of all parties. In their study of different policymaking perspectives, Armijo and Echeverri-Gent (2014) explain that the Neo-Liberal school of economics that dominated America and other wealthy democracies' policymaking circles, emphasizes the absolute gains achieved by efficient global markets. Meanwhile, the Liberal Institutionalism economic thought in the global North academia, highlights absolute gains of global public goods, provided by international institutions.

The LIO consisted of a thick international order promoted by the U.S., seeking to integrate all possible countries in a set of economic and political international organizations that govern the international conduct of nations. Further, the unipolar structure of the system meant that the U.S. could comfortably police the rule-based system (Mearsheimer 2019a). The few states that imposed challenges to this system were not great powers and hence could be easily punished by isolating them from the system until they changed their behavior (Nephew 2018; NSS, 2010: p12).

From an economic perspective, this global setup bears the most possible resemblance to the functioning of a domestic economy: the economic logic of absolute gains and efficiency – in contrast to the security considerations of relative gains – defines the interactions of the agents. The existence of rules and an authority that can credibly enforce them provide the public good of the institutional setup required for the operation of the economic agents.

Such a world could use the efficiency gains of a single international currency (IMF 2001) to operate as the money of moneys long after the dollar had assumed the position of the dominant currency around 1929 (Chitu, Eichengreen, and Mehl 2012). Nonetheless, in theory, the expansion of the Western bounded order to a liberal international order only increased the appeal of the greenback. Evidence shows rapid growth in the share of the dollar in world reserves immediately after the Cold War ended (Norrlöf 2020). Notably, this falsifies the 'dollar for security' predictions of the fall of the dollar's status for allies' reduced security demand after the Cold War (Kirshner 2005; Helleiner 2008; Mastanduno 2009).

Following chapter one in breaking down the use of the dollar by its functions (Norrlöf 2014; Cohen 2015; McDowell 2023), the medium of exchange role soars by the emergence of the LIO and its neoliberal economic agenda of hyper-globalization. The increased volume of transactions by private economic agents requires increased supplies of money to lubricate the trade and financial flows. It also necessitates the central banks to be prepared for interventions in foreign exchange markets on larger scales and to support liquidity to emerging international financial institutions. This requires central banks to hold larger piles of reserves currencies as their "liquidity tranche" (Lu and Wang 2019).

When the United States is a net importer of goods and services and many emerging markets are net exporters (The World Bank 2024), dollars could be stockpiled by the exporters' supply of the greenback to the central banks in exchange for domestic currencies. Resulting from the amplified economic activities and accumulation of wealth due to continued economic growth, the need for storing value – the "investment tranche" (Lu and Wang 2019) – increases by both private actors and the central banks.

Increased trade and development of financial markets, everything else held constant, further upsurges the volume of debt and trade denominated in dollars. From an instrumentalist perspective (Oatley 2014) adopting a peg to the dollar, either to achieve price stability in monetary policy or to increase competitiveness via an overvalued exchange rate for trade policy purposes, is the most relevant for emerging markets with an export-led economic growth model. Hence, it would not be surprising to see the emerging markets as the biggest dollar hoarders during the LIO. Although the choice of peg currencies is relatively stable over time (Ilzetzki, Reinhart, and Rogoff 2019; Arslanalp, Simpson-Bell, and Eichengreen 2022), Li (2003) and Posen (2008) show the effect of security considerations in choosing the pegged-to currency. From a geopolitic standpoint (Oatley 2014), the United States as the unipole of the LIO enjoyed a unique position in providing security for such countries.

Finally, the U.S.-led international institutions – including the IMF, the World Bank, and the WTO – that work to integrate the international economy and address the financial distress of nations, were expanded to operate on a global scale compared to their presence in the bounded Western order of the Cold War era. This elevated the status of the dollar in all of its roles in the international public sector.

However, the rise of the GEO undoes many of those developments that favored the dollar during the LIO. The gears shift from globalization to protectionism and the salience of security concerns lowers global trade and investments. Of the outstanding global transactions, some would be diversified away into parallel non-dollar-based payment systems to hedge against geoeconomic risks. Open economies that lean back toward a more closed setup hinder the efficiency of the international economy. The frictions in international transactions arise due to the void of a single currency and payment system as the global public good. All of these disruptions contribute to the instability of the global monetary and financial system.

Consequently, a slowdown in global output could be expected, with more severe consequences for emerging markets (IMF 2024). Lower incomes would decline the economic demand for dollar securities. A trend which is reinforced by a series of political factors. The risks associated with increased polarization in U.S. politics, evident in the recent 'debt brinkmanship' (Pottinger and Singh 2023), limit the Federal Reserve's technical ability to oversee the dollar's performance. Mismanagements inherent to the core node of the system (Khanna and Winecoff 2020) propagate a global loss of confidence in the greenback. Moreover, the risks associated with U.S. foreign policy, such as a growing worldwide perception of the arbitrariness of U.S. financial sanctions (Mulder 2022; Demarais 2022), make the states and firms rethink the role of the dollar in their operations. Led by the developing countries (World Gold Council 2023), central banks are stashing record-high amounts of gold as a safe haven (World Gold Council 2024).

Furthermore, economic growth during the LIO, wherever accompanied by improvements in local institutions, makes countries more adept at achieving macroeconomic stability without relying on currency pegs. Empirical evidence suggests that dropping currency pegs significantly reduces the dollar reserves (Arslanalp, Simpson-Bell, and Eichengreen 2022). In addition to the economic components of demand, moving toward multipolarity in the systemic order simultaneously limits the U.S. abilities of security provision and expands the options of those who seek security.[1] This decreases the political demand for dollar pegs as well. Additionally, the initiatives for pricing oil and commodities in other currencies (Said and Kalin

[1] Note that if a small country has two options of to oppose or to align vis-à-vis a great power, its options will double every time the poles of the system increase by one. For example, these two options under unipolarity increase to four under bi-polarity: to oppose A and align with B, and vice-versa, and to align with both, or neither.

2022; Chestney 2022), erode the dollar's monopoly in commodities pricing. Since the settlement currency is almost always the same as the invoicing currency (McDowell 2023), fewer trades occur via the dollar.

Finally, a more fragmented world poses existential threats to American-led international organizations such as the IMF (Gourinchas 2022). With the Western bounded order shrinking back and making room for the rise of the Eastern bounded order (Mearsheimer 2019a), Chinese-led international institutions like the Asian Infrastructure Investment Bank (AIIB) and the People's Bank of China step up to provide alternatives to the IMF services (Hill and Emmer 2021; Wheatley and Kynge 2022). This will threaten the dollar in international organizations' sizeable reserves.[1]

Table 3.1 recaps this section's review of the major shifts in the dollar's global outlook. In what follows, I will investigate the extent of their geoeconomic significance.

Table 3.1: The Dollar Under the LIO and the GEO

Domain	LIO	GEO
Foreign Exchange Reserves	• Liquidity and investment tranches of firms, governments, and IOs • Currency pegs	• Economic and political risks of holding dollar assets • Limited role and scope of IOs • Less demand and more options for currency pegs
Payment System	• Maximum trade • Efficiency gains of a single infrastructure	• Limited trade • Security gains of not relying on one infrastructure
Debt Issuance	• Steady global demand for dollar assets	• Economic and political factors of demand fluctuations

3.2 Payment systems, financial sanctions, and the dollar's global role

This section focuses on the specific role of the dollar-based payment system in providing the public good of global money during the LIO. As McDowell (2020; 2023) explains, the dollar-based payment system consists of three elements: 1. The currency that

[1] IMF roughly holds 891 billion dollars of international currencies as of 30 June 2023 (IMF 2023b; 2023c).

flows through the system – the dollar 2. The messaging system – SWIFT 3. The clearing system – CHIPS. International networks such as the Society for Worldwide Interbank Financial Telecommunications (SWIFT) and the Clearing House Interbank Payment System (CHIPS) act as the necessary infrastructure that makes it possible to use the dollar on a global scale. In other words, the supply of these infrastructures by the U.S. and other advanced economies provides a network that responds to the worldwide economic demand for the use of the dollar, and in the meantime, reinforces the demand through network effects. As noted earlier, once in place, such global infrastructures are hard to substitute.

Farrell and Newman (2019) show the evolution of the SWIFT network that enables interbank communications. To do so, SWIFT should have access to all the information passing through different nodes in the system. The United States for its influence over SWIFT can exercise the panopticon effect: take advantage of this information to its benefit (Farrell and Newman 2019). While SWIFT provides such information, actual payments occur via CHIPS (McDowell 2023), and it is where the real geoeconomic advantages of the U.S. as the issuer of the global currency lie. Washington controls the critical nodes of the network, a collection of a few giant financial institutions that function as the banks of banks. Operating in the United States and being subject to its law, the White House can instruct these institutions to block certain transactions and freeze the funds, giving the government the ability to exercise chokepoint effects (Farrell and Newman 2019).

These financial infrastructures provide significant geoeconomic leverages for the U.S. Their importance can be best understood once one compares the financial sanctions enabled by these infrastructures to the traditional trade and investment sanctions – including bans and embargos – that preceded them. Financial sanctions emerged in the aftermath of 9/11 to cut off terrorist groups from the global economy (Zarate 2013). However, later their use was expanded to target governments and entire nation-states, to the point that as of 2019, nearly 70% of all sanctions programs were targeting states (McDowell 2023).

The idea behind financial sanctions is to restrict the flow of any non-barter trade by controlling the monetary leg of transactions, instead of going into the trouble of preventing the physical flow of goods and services (Carter and Farha 2012). The latter option would require the traditional measures of deploying military troops and naval blockades (Mulder 2022), and yet, were mostly ineffective in targeting the intended audience (Zarate 2013; McDowell 2023). Whereas the financial sanctions enable U.S. politicians to target specific entities around the world from the comfort of their office in Washington.[1]

The widely misused term "weaponization of the dollar" (e.g. McDowell 2023:46) refers to the weaponization of the payment system, not the currency itself. Since two entities may trade using dollars but outside the U.S.' control – for instance, to pay using cash. It is also possible for the U.S. to monitor and project power over payments with other currencies, such as a transaction in euros via SWIFT since it is not limited to the dollar-denominated transactions. Headquartered in Belgium, SWIFT also processes non-dollar financial messages (Farrell and Newman 2019). The U.S. government cannot track physical bills of dollars – or the Eurodollars[2] worth half of all dollars' value (U.S. Currency Education Program) – unless they enter the American financial system. Typically, this is not a problem. The infrastructural nature of the payment system and the network effects it generates leaves the financial actors, especially the biggest ones, with almost no alternatives. Although not entirely impossible, it is impractical to stash and trade with large piles of physical dollar notes.[3] Hence, any substantial cross-border transaction at some point shows up on the U.S. Office of Foreign Assets Control's

[1] The findings of recent studies (see Salehi-Isfahani 2022; Kahalzadeh 2023) defy the stated purpose of smart sanctions that only target designated individuals to avoid humanitarian consequences for the entire population, suggesting that they bear more resemblance to the weapons of mass destruction rather than sniper rifles.
[2] Dollars in circulation outside the U.S. geographical borders.
[3] McDowell (2023) reviews the use of physical gold by Venezuela in international payment. But such practices are out of dire necessity and too costly to be routinely used.

radar. Moreover, even the financial institutions that do not have global operations, at some level connect with the CHIPS through larger institutions. Hence, if secondary sanctions are in place, any entity in contact with a designated agent will be cut off from the CHIPS and the dollar-based payment system (Smeets 2018; McDowell 2023). Using the mechanism of secondary sanctions, the U.S. expands the voluntary and independent enforcement of the U.S. law by private actors – known as the "public-private feedback loop" (Loeffler 2009) – beyond its territory.

Financial sanctions lie at the core of the currency geoeconomics since they are both enabled by the public good quality of the dollar and at the same time, their implementation erodes this quality. Exploiting the chokepoints in the payment system by cutting off some actors from using the network transforms the nature of this infrastructure. By definition, financial sanctions alter the dollar-based payment system from a global 'public good' to a 'club good' – the club being the comprehensive political-economic Western camp.[1] This is what makes the financial sanctions essentially different from other geoeconomic means when it comes to their effect on the global currencies debate.

McDowell (2023) explicates how financial sanctions can be designed to target the different roles of the dollar as the store of value or the medium of exchange. As a one-off action, freezing the dollar assets of an entity is both easier to implement but also to prevent by the sanctioned party. By converting dollar-denominated securities to gold or other financial assets beyond the U.S.' reach, as Russia did in its preparation for invading Ukraine, countries can overcome the seizure of their wealth by the Treasury. On the contrary, imposing restrictions on using the dollar as the medium of exchange, by cutting off the sanctioned entity from the dollar-based payment system is what makes for an ongoing punishment that is both harder to

[1] Economists usually define public goods by the two qualities of being non-rivalrous and non-excludable. Club goods, on the other hand, are non-rivalrous but excludable (Buchanan 1965).

implement and to overcome (McDowell 2023). Strikingly, while the debate of sanctions' effects on dollar dominance profoundly focuses on FXR, "the overlooked role of the dollar as the top international payment currency" (McDowell 2020) merits more geoeconomic attention.

Nevertheless, chapter two suggests that like other global infrastructures, the dollar-based payment system also comes under duress in a geoeconomic world. It will eventually lose its political leverage once the U.S. adversaries stop relying on it or using it at all. Similar to the fragmentation and diversification scenarios in the previous chapter, public and private sectors can choose the 'flight to safety' option by cutting all financial ties outside their comprehensive political-economic club. The U.S. Congress has already been warning American firms to beware of the consequences of parking their money in China (Dollar Dominance 2023). On the other hand, those actors who are not completely aligned with either club or prefer to keep doing business with all sides, have incentives to diversify their options to hedge against the geopolitical risks of great power rivalries. For instance, Liu and Papa (2022) show that not all the members of BRICS are subject to strategic incentives to de-dollarize. Yet, they are precautionary hedging against currency shocks with political origins by developing alternative payment systems.

Financial sanctions are not of trivial economic importance even in the long run. Indeed, they are a mighty weapon in the hands of policymakers with devastating effects on the target economies. For such effectiveness is achieved by low political costs (Drezner 2021; Demarais 2022), but also because of the domestic political economy they create in both the imposer and the target countries (Eyler 2007; Kaempfer and Lowenberg 2007), it would be naïve to expect that the great powers will ever holster this gun. Nevertheless, The effectiveness of sanctions – the ability to impose pain on the target (Nephew 2018) – should not be mistaken with their success in achieving their political goals – to alter the target's behavior (Smeets 2018). In fact, as Drezner (1999) shows, sanctioning is more probable wherever they are less likely to succeed.

Hence, insofar as our definition of geoeconomics – the use of economic means for political ends – is concerned, financial sanctions have not been much successful in delivering political results, and would be even less so going forward.

From the perspective of both the Harvard and Berkeley economic outlooks that I mentioned before (Eichengreen 2019b), global responses to financial sanctions would increase the potential for dollar dominance inside the Western block. Dollar's elevation in any of its classic roles (store of value, means of payment, and unit of account), according to the Harvard view, reinforces its position in other roles. Moreover, a smaller world divided into political blocks where some big emerging markets like China lie outside of the Western camp makes the 'new Triffin dilemma' less relevant of a concern for Berkley people (Gourinchas 2022). On the contrary, from both the instrumentalism and geopolitic perspectives in the IPE (Oatley 2014), these responses harm the global status of the dollar. With gaining autonomy from economic coercion being a central objective of many foes and allies of Uncle Sam alike (Demarais 2022), the instrumentalism view predicts a surge in the use of alternative systems. In addition, the geopolitic framework suggests that the relative decline in the U.S.' military and economic power in the emerging multipolar world would curtail the dollar's global appeal. In short, "the dollar-centered financial system is becoming less widespread but more entrenched where it persists" (Norrlöf 2023a).

3.3 Short-term liabilities, long-term geoeconomic assets[1]

As established earlier, the political exorbitant privileges of issuing an international currency diminish under the very geoeconomic circumstances that enable them. In the current geoeconomic order, the United States is employing financial sanctions to unleash the political privileges of having the king currency. Like other geoeconomic means, the idea behind

[1] Around 80% of all the US government's issued debt between 2006 and 2016 had a maturity of one to five years (Belton et al. 2018).

financial sanctions is to exploit the dependencies on the greenback in its global roles. However, these sanctions are provoking counter-movements against the currency (Demarais 2022; McDowell 2023). As is the case for all geoeconomic means, once interdependencies disappear or adequate alternatives are in place, the political privileges of dollar dominance will no longer be potent.

Nonetheless, how about the economic privilege? Previously, I reviewed the literature to show that the renowned exorbitant privilege – the ability of the United States to borrow cheaply, largely, and lengthily (Gourinchas, Rey, and Sauzet 2019) – can and has been put to strategic use. Debt-financing of military costs has been a pillar of the U.S. hegemony that was made possible thanks to the dollar's supremacy in the global economy (Oatley 2015). Unlike the soft powers of the political privileges, the economic benefits of issuing an international currency are not about cutting mutual ties which hurts both ends, but the adversary loses more (Kim 2019). They are about benefiting from the economic advantages of the dominant currency, which among others, can provide resources to be used for financing the issuer's hard power. Hence, they do not require economic interdependencies with one's adversaries. As long as friends or neutral states are willing to purchase its debt, the United States can use those funds to contest its foes.

Fortunately for the America, not only about 50-60% of all dollar-denominated foreign exchange reserves are held by geopolitical allies of the U.S. (Weiss 2022), but also roughly 60% of the world income (that can be used to purchase securities) belongs to the developed countries of the 'global North' (UNCTAD 2023, see Figure 3.1). The overlap of these two sets of countries hints at the probable continuity of the economic privilege for the foreseeable future.

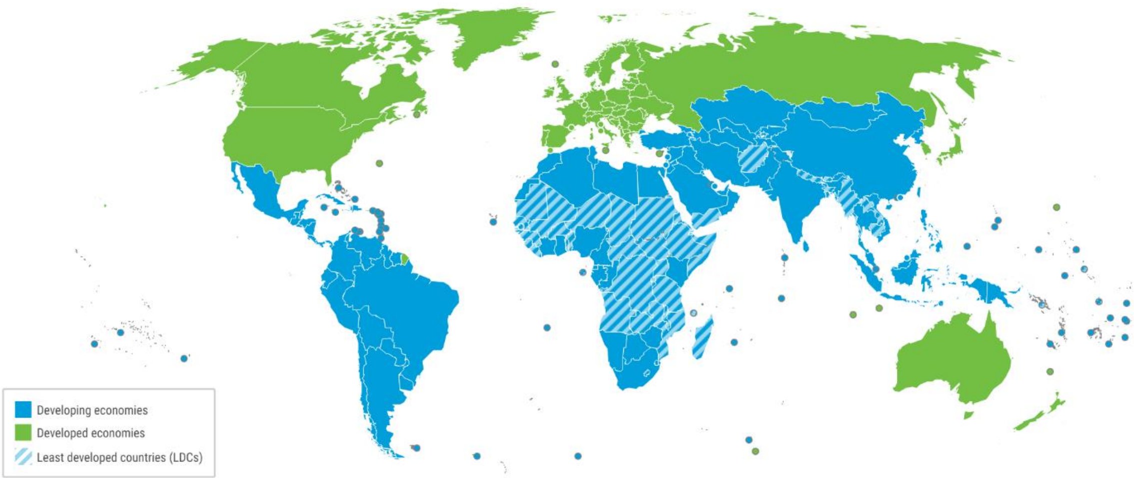

Figure 3.1: World by Development Status.
Source: (UNCTAD 2023)

The literature emphasizes the void of adequate alternatives to USD to satisfy the global supply of savings. Hence, in general equilibrium, the total demand for the United States' financial assets will not change eventually even if some big customers like China threaten to take their demand off the table (Pettis 2019). Nonetheless, in the short term, such threats can interrupt the Federal Reserve's business as usual. Figure 3.2 depicts the changes in the holdings of the treasury securities at the end of December for 2000-2023. Changes in China's holdings simply reflect its net position in accumulating or dumping these financial assets. Meanwhile, the changes in the grand total value denote the net debt issuance or settlement by U.S. treasury.

This graph depicts how China has changed its official strategy from being a chief buyer of U.S. securities, with a pivotal role in bailing America out of the 2007 financial crisis, to a net seller of them. Even if China isn't really pulling out of purchasing U.S. debt, as Setser (2023) argues, temporal interruptions in the inflow of foreign capital can disrupt the Federal Reserve's 'cocktail party' (Krippner 2011:104) and tighten their policymaking constraints. In this light, the global debt markets in the short term can have long term consequences for international politics.

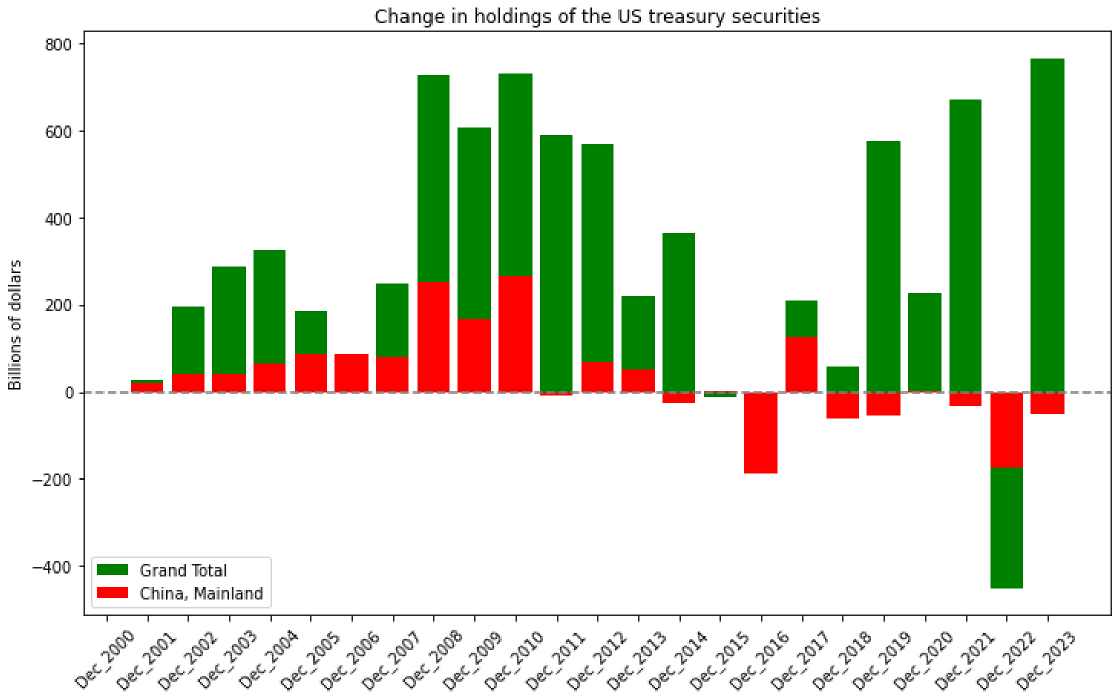

Figure 3.2: Changes in the Holdings of the U.S. Securities
Own calculations based on the Treasury's data (Portfolio Holdings of U.S. and Foreign Securities 2024)

In this chapter, I argued that the process of elimination helps us to understand the most geoeconomically potent aspect of international currencies in the 21st century. The domination of the U.S. dollar over the international payment infrastructure makes those financial sanctions that target long-term access to global economic transactions much more potent than the one-time seizure of foreign exchange reserves. Yet, there are theoretical ways around them, and some initiatives have already been materialized. However, besides the risks associated with the demand fluctuations in the short term, there are no easy ways for countries to prevent the United States from continuing to debt-finance its arsenal of geopolitical tools. The overlooked role of the dollar in debt issuance is what I believe is the greatest geoeconomic privilege of the U.S. and what should be studied more in the future. Table 3.2 summarizes this chapter's core arguments.

Table 3.2: Geoeconomic Potential of International Currencies

Roles of International Currency	**Benefits (Exorbitant Privilege)**		**Geoeconomic Potential**
	Economic	Political	
Foreign Exchange Reserves	-	Freeze assets (Easy to implement, easy to counter)	The least (Requires short-term/ transactional dependencies)
Payment System	-	Block access to the global payment system (Difficult to implement, difficult to counter)	In-between (Requires long-term/ infrastructural dependencies)
Debt Issuance	Military finance	-	The most (Does not require dependencies with adversary)

CONCLUSION

International currencies have long been of great interest to political scientists who appreciate the dynamics of money and power. As the most dominant global currency by far, the U.S. dollar is the centerpiece of numerous studies that try to shed light on the strategic implications of international currencies. The proliferation of geoeconomic practices over the course of the past two decades has only amplified interest in the subject. However, the canon still lacks theories that can map the economic specificities of how global currencies work on how they are (or can be) used in international politics. Such theoretical shortcomings particularly surfaced when the signs of a shift in the world order first appeared around 2018. Later, the United States introduced financial sanctions into great power politics in the outbreak of the war in Ukraine to make many wonder about the prospects of dollar hegemony, especially if the U.S.- China rivalries intensify in the near future.

The greenback's status in foreign exchange reserves is the most noticed aspect of dollar dominance in academia as well as policymaking circles. However, a closer look suggests that it bears the least strategic relevance. This is while the opposite is true for the debt denomination role of the dollar as the dominant international currency. This study decomposes the exorbitant privilege of the dominant currency into its political and economic dimensions. The political aspect refers to the notion of the issuer exploiting the dependence of others on the currency. United States can use financial sanctions to freeze the dollar assets of its adversaries or block them from using the dollar-based international payment system. I argued that posing financial sanctions eventually erodes the political privilege of dollar hegemony. This is achieved either through the world's fragmentation into separated political-economic camps, or by countries diversifying their economic governance to avoid strategic reliance on the U.S. and its currency.

The economic privilege, however, can continue to profit the U.S. thanks to the economic incentives of its wealthy allies. The key economic benefit of a global currency lies in the ability that it provides its issuer with to run huge deficits. In the context of great power politics, this opportunity can be invaluable in financing one's strategies, including the hard power. Nowadays, geoeconomic means are the primary tool of foreign policy around the world. However, these means rely on exploiting mutual inter-dependencies that will vanish under the decoupling scenario or will lose their edge due to diversification. Hence, as disappointing as it sounds, states would once again reach out to their guns and fight wars in the future. Figure 1 summarizes the international political economy context in which,

Table 1 presents the core arguments of this text.

The inductive and abductive reasoning put forth in this research, however, is not without limitations. I already stressed the complexity of how international currencies work in their multiple functions. Particularly, I hinted at the roughly mechanical stock and flow relationship between the foreign exchange reserves and dollar-denominated debts, respectively. Given that the literature inspects the former and I accentuate the latter, while the two are intrinsically connected, my conclusions might seem to only justify the literature's point of emphasis. Nonetheless, the revelation of my literature review and the very theoretical gap that incentivized this research was the lack of an expressed link between the FXR and any political leverages associated with it. The literature might rightly be attending to the indirect results of debt issuance as they appear in the FXR, but not for the right reasons. To delve deeper into this relationship exceeds the time and space constraints of this thesis.

Future work in the area of currency geoeconomics can explore two main avenues. Empirically, the framework offered here could use further support. Hence, quantitative and qualitative studies on both the cross-case level correlations and within-case level studies are needed to lend support or falsify these theoretical conjectures. An example of such empirical research designs is proposed in Table 2.2. Theoretically, future research should invest in studying the global debt markets and their conjunctures with international politics. For instance, how can the United States preserve the global demand for its dollar-denominated securities, and what are the implications for the investment atmosphere and the international financial markets around the world? Hopefully, the advent of such theories will elevate our appreciation of the nuanced dynamics of money and power in global affairs.

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