

Funding the Future

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Issuing the world's reserve currency gives a country the advantage of not having to, in effect, pay for many of its imports. Trump has never understood that.

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This is the transcript:

Are the dollar's days over? That's a question I need to ask because there has to be doubt about whether the US dollar can now be the world's reserve currency.

The doubt has of course been created by our great friend Donald Trump who has done everything he can to undermine the credibility of the US economy in the eyes of the rest of the world, and of course, therefore, he is putting the status of the US dollar as the world's reserve currency at risk.

So, what is a reserve currency, and can they cease to hold that status? These are the two particularly important questions to answer.

The second one is the easiest and quickest to answer and is important simply because it makes the rest of the consideration relevant, and the answer is that a currency can

cease to be the world's reserve currency. And we know that's true because until, near-enough, the start of the Second World War, the pound sterling, issued, of course, by the United Kingdom, was the world's reserve currency.

We ran the biggest empire in the world.

We did more of the world's trade than anyone else.

And as a consequence, the pound sterling, backed by the Bank of England, was the reserve currency of the world.

And, the Second World War did for that. We were no longer in any position to dictate terms to the rest of the world when, at the end of that war, we had national debt of 255% of our gross national income as a country, and therefore our money was in deep trouble in a very real sense because we had had to borrow so much from the US during the course of the war, which we had to repay over the following 30 or 40 years, which we did largely as a consequence of inflation writing the value off over that period.

But that's not the point. To, therefore, ask what is a reserve currency, and can the dollar lose that status, are both highly relevant questions.

So, what is a reserve currency? A reserve currency is quite simply the most trusted currency in the world.

Remember that all currency is money and all money is debt. It's a promise to pay.

There is nothing that actually now backs up the value of the dollar, and even when the pound sterling was officially a reserve currency, there was never really enough gold to back up its value.

The fact is that people trust the dollar because they've always trusted the USA to be able to make payment of its debts ever since the time of World War II, when it became the world's dominant economic power, largely because of course not a single bomb fell on the whole of the USA excepting Pearl Harbor.

So the US was the world's most powerful nation, and it issued the world's most powerful currency, and it was the richest country in the world, and it partook in more trade than just about any other country as well, meaning that the dollar was available everywhere. And, as a result of the dollar being available everywhere and everyone believing that the US would always back up its promise to pay, which is fundamental when it comes to the issue of a currency, it was used to trade some of the world's key commodities.

Obvious things include oil, which has been priced in dollars virtually since the Second World War, and gold, and wheat, and some other fundamental products. Orange juice, for example. All of those things are traded in dollars, and that makes the dollar extremely powerful.

But it's more than that. Not only does it facilitate trade, it also in a sense creates a store of value. What it proves is the value of something. The dollar price of gold proves to every other country what the value of gold is in their currency, because their exchange rate can be related to the value of gold set in dollars. So the reserve currency in this sense helps to establish norms for valuation around the world, but it does something more.

In some cases, not many now, but in some cases, the reserve currency of the world even provides a peg or basis for valuation for a currency as a whole. For example, Panama uses the US dollar as the basis for its own currency, but it does issue its own dollars. They're just at a fixed exchange rate with the US dollar, and that is something that does happen. It's not terribly important, but I think I should make the point.

More important by a long way, is the fact that very large numbers of central banks around the world will wish to hold foreign reserves to ensure that their countries can settle their debts as they fall you. If the dollar is the currency in which the world's debts are denominated, and indeed, in which very large proportions of the world's debt is actually issued because, for example, things like the World Bank and the International Monetary Fund, as well as very large parts of the world's financial markets, all issue their debts and other forms of financial instrument in dollar denominations, then the central banks of the world need to hold dollars to be able to ensure that they can settle those dollar debt liabilities.

And that means that this is a reserve currency because it is held in reserve to guarantee that debts can be paid. That's where the name comes from. But as a consequence of that, it means that having sufficient dollars in the world to ensure that debts can be paid is important and for that reason, there's actually a very important role that the USA has to play, which is it has to pump enough dollars out into the world to guarantee that the dollar can play this role.

Now, all of that is under threat. Those characteristics of the reserve currency, the facilitation of trade, the store of value, the pegging of value for some currencies, the financial market functionality in the form of providing reserves, and the provision of confidence and liquidity, all of those things are under threat because of what Donald Trump is doing.

He's basically saying he does not want to issue more debt into the world. He says that he wants to cut the value of the US federal debt, but the value of the US federal debt, something like \$36 trillion at the moment, is actually the value of the outstanding dollars in the world, which are used for the purpose of it being a reserve currency.

And if he's going to threaten that status, or if he's going to start playing silly games with the value of the dollar by undertaking trade wars, which clearly he is, or if he's also going to play further silly games by threatening the Federal Reserve to demand that the interest rate paid on the dollar might be artificially pegged in a way that the market

doesn't like, then the reserve currency status of the dollar is immediately prejudiced.

The fact is that once somebody starts to play with the value of their currency in this way, that currency normally becomes toxic. Nobody wants it. It's a simple, straightforward statement of fact. And if you doubt that, have a look at what has happened to the Turkish lira over the last 10 years or so, which has been destroyed by the policies of President Erdogan.

Now, my point here is therefore, that Trump is threatening just by those simple, straightforward facts, 📍 by playing with tariffs, undertaking trade war, and threatening to change the interest rate on the dollar, the reserve status of that dollar.

What's the consequence? Well, it means that the USA would lose the enormous, fundamentally important economic advantage that it has secured by having the world's reserve currency. And that advantage is something which is the absolute opposite of what Trump says day in, day out.

The fact is that the world has not taken the USA for a ride by running trade surpluses with the USA, in other words, selling more into the USA than they buy from the USA. That's an inevitable consequence of the fact that people who sell goods into the USA want to keep the dollars they're paid and they need to keep the dollars they're paid because unless they keep the dollars they're paid, their central banks can't hold dollars, and therefore there isn't the opportunity to provide the financial liquidity that the world's financial markets need.

So, the world can't afford to buy from the States as much as it sells to the States, because otherwise there would not be enough dollars in the world for the dollar to be the world's reserve currency.

It's a simple, straightforward statement of fact that I just made, but it seems that Donald Trump doesn't understand this.

But what he also doesn't understand is something actually very, very much more fundamental, which is that what this really means is that the USA has effectively bought those imports into the US, which have boosted the standard of living in that country, effectively for nothing because people don't actually want to redeem the dollars they're paid. That means, therefore, that the rest of the world is not exploiting the USA. It's subsidising it. He's got everything the wrong way round; as simple and straightforward an error as can be made in economics. That's what Donald Trump has done.

So, what happens now if Trump really does remove the status of the dollar as the world's reserve currency?

First of all, we'd need to decide what else might be the world's reserve currency. It's definitely not sterling. A small island off the northwest of Europe is not now in the

position to provide the world with that facility. The pound is out of the running.

The Euro could be in the running, but obviously, there are problems. It does not represent the currency of any one state, but the currency of multiple states, and it does therefore have some inherent uncertainties in it.

So could it be the Japanese currency, the yen? Highly unlikely because the yen has been operating in such an unusual financial market for so long because of the scale of Japanese national debt, which is well over 200% of GDP now, that this is unlikely to provide an alternative.

Nor, frankly, can China stand up and provide the alternative at present. It simply isn't trusted enough. That is a fundamental problem for it at present.

So could it be that the world's alternative reserve currency, and there may be such a thing, will not be any of those currencies, but a basket of them, maybe including the dollar, but something like Lord Keynes described in 1945, when he wanted to create something called the Bancor, B-A-N-C-O-R, the Bancor, which was going to be used purely for the purposes of international trade settlement and which was a weighted balanced basket of world currencies that would move gradually in composition of value over time to reflect their broad movement in trading conditions between those countries, but which would provide a means of settlement, which the international banks could then hold, and which central banks could hold to ensure that they had international liquidity.

That is entirely possible. It is, in fact, the obvious way to go forward and to make it viable and to provide a more stable world situation; this should obviously include currencies of other major nations, Brazil, South Africa, India, but even smaller countries in the world could partake as well. There is no reason why not, and then they might be able to borrow in their own currency, with that fact being taken into account in the weighting of the Bancor itself, providing as a consequence, less dependence of those states on internal politics in the USA, which will be a blessing to everyone.

And what will happen to the USA if it loses reserve currency status? It will have to pay for its imports. That will reduce its standard of living, significantly.

Trump thinks he's actually going to boost America by punishing those people who have been running trade surpluses by over-supplying imports into the USA. He's actually going to punish America by forcing the people of the USA to finally pay for the items that they bring in from overseas, which they have not needed to do because the dollar has never been redeemed.

It's an interesting, a difficult, a turbulent time, but we need to get our heads around this because if Trump destroys the dollar, as well he might, we are in uncharted territory because when the pound failed, the dollar was available. Now, as the dollar fails, there

is no other currency obviously available, and therefore, we need to think hard now about what might happen.