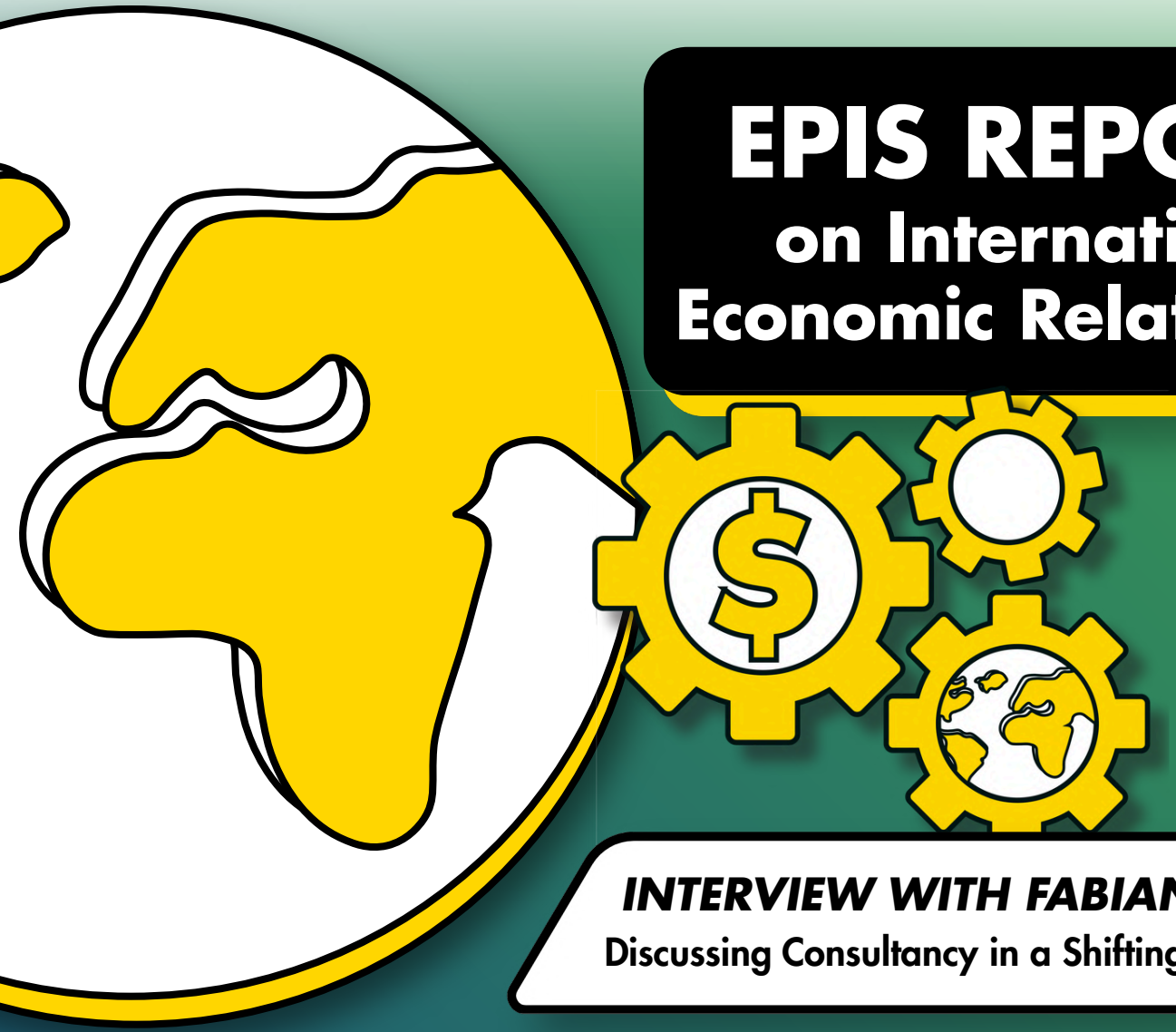
EPIS Thinktank
foreign affairs & security policy

Issue II
May 2026
epis-thinktank.com

EPIS REPORT on International Economic Relations



INTERVIEW WITH FABIAN VETTER

Discussing Consultancy in a Shifting Landscape

Monetary Blocs and International Currency

As in the past, the fragmentation of the global economy and the formation of geopolitical blocs inevitably lead to the emergence of monetary blocs and changes in the system of international payments and international currency. In this text, we will attempt to outline some key elements of the dynamics of these changes and the possible trajectories for the formation of a new international monetary architecture.

The Future of the Petrodollar

Main question: How might the energy transition affect the role and underlying strengths of the USD as the world's reserve currency. Argument: one of the main pillars of USD dominance in global reserves is the 'petrodollar' system in which oil sales are denominated in dollars, requiring central banks to hold them in reserve. With the world increasingly less dependent on the oil trade, could this undermine the system? It may be a contributing factor to the depolarization of currency reserves

Table of Contents

Editorial

6 **Editorial Team and Contributors**

10 **Editorial by Donat Olah**

Articles

14 **Monetary Blocs and International Currency**

As in the past, the fragmentation of the global economy and the formation of geopolitical blocs inevitably lead to the emergence of monetary blocs and changes in the system of international payments and international currency. In this text, we will attempt to outline some key elements of the dynamics of these changes and the possible trajectories for the formation of a new international monetary architecture.

22 **The Future of the Petrodollar**

Main question: How might the energy transition affect the role and underlying strengths of the USD as the world's reserve currency. Argument: one of the main pillars of USD dominance in global reserves is the 'petrodollar' system in which oil sales are denominated in dollars, requiring central banks to hold them in reserve. With the world increasingly less dependent on the oil trade, could this undermine the system? It may be a contributing factor to the depolarization of currency reserves

30 **Dollar Dominance and Competing Currencies**

What is the future of dollar dominance? This report argues the dollar will not be displaced despite geopolitical tensions and digital innovation, due to its structural and infrastructural advantages. Instead, the system is becoming more fragmented and multipolar. By 2050, the dollar remains central but but no longer uncontested.

42

The Weak Yen Trap

Q: Does Japan's dollar exposure prevent the BoJ from raising rates? Arg: Low rates fuel carry trades that weaken the yen, while $1T+ in U.S. Treasuries ties Japan to U.S. monetary cycles — a self-reinforcing trap. Concl: Gradual normalisation is the best exit, but political pressures keep the status quo attractive.

52

Is the world moving beyond SWIFT?

Can CIPS, SPFS, and mBridge realistically replace SWIFT as the backbone of global financial messaging and settlement? Each alternative serves a distinct purpose: RMB internationalisation, sanctions resilience, or CBDC-based settlement, but none replicates SWIFT's scale, and most still depend on it. The payment infrastructure is evolving toward multipolarity, not replacement — parallel systems are emerging, but SWIFT remains the global standard for now.

62

Designing Sanctions

To what extent does international law constrain the EU's use of Russian central bank reserves? This article argues that sovereign immunity and the limits of countermeasures not only restrict the EU's action but directly shape its sanctions design. It concludes that outright seizure of assets would likely be unlawful, and that any financial sanctions must be designed around the limits of international law.

72

Dollar Dominance: The Fed's Geopolitical Shadow

Main Question: How does Fed monetary policy shape US geopolitical power, and what does the Powell-to-Warsh transition mean for dollar dominance? Argument: The dollar's reserve status turns every Fed decision into a geopolitical event, enabling financial sanctions while keeping BRICS alternatives marginal. Conclusion: Warsh's hawkish instincts can reinforce dollar credibility, but ultimately, his goal is not to push US geopolitical objectives.

80

The Euro as an international currency

Should the ECB push the Euro internationally to incentivise smaller economies to take the Euro on as their anchor currency? The general trend point towards a de-risking internationally with countries increasingly preferring baskets over a single currency, and the most attractive policy remains domestic stability. The ECB should not let itself be distracted by geopolitical opportunism and rather focus on domestic price stability.

88

The Euro: Power without Autonomy?

Main question: Why has the euro's monetary power not translated into full EU strategic autonomy? Argument: While the euro functions as a growing geoeconomic tool (sanctions, trade, finance), its impact is constrained by EMU's incomplete architecture, dollar dominance, and fragmented political and financial integration. Conclusion: Without deeper fiscal, financial, and political union, the euro cannot fully rival the dollar or deliver true strategic autonomy.

98

Digital Currencies and their Implications

Asks how the introduction of the digital euro could impact International Relations, through changes in monetary power. The digital euro could strengthen the European Union by increasing monetary sovereignty, reducing reliance on U.S.-based payment systems, and expanding the EU's regulatory influence globally. The paper concludes that the digital euro could enhance the EU's strategic power in global finance, but its success depends on managing risks.

106

Who Controls Money?

How do cryptocurrencies affect financial stability and security compared to gold? Both rely on scarcity but differ in relation to state power. Gold is embedded in state systems and supports stability, while cryptocurrencies enable decentralized transfers outside institutions. This weakens sanctions and oversight, increases volatility, and shifts financial authority away from states.

Interviews

116

Discussing Consultancy in a Shifting Landscape

Main Question: How can businesses navigate an increasingly fragmented and uncertain geopolitical landscape? Argument: Companies must integrate geopolitical analysis into their core business strategy rather than treating it as an external factor. Conclusion: As global dynamics grow more complex, the demand for experts who can translate political trends into strategic business decisions will continue to rise.

Policy Proposal

120 **The Mutual Industrial Resilience Program**

How can the EU overcome structural vulnerabilities while reforming its slow, politically driven enlargement? The EU must deploy the €30B Industrial Resilience Facility and an EIB-backed 70% political risk insurance mechanism to embed candidates into European energy, technology, and manufacturing value chains. Enlargement must evolve into a mutual security strategy; by tying candidate stability directly to EU economic resilience, Europe builds an "industrial security belt."

Columns

124 **Conclusion by Donat Olah**

126 **Supply Shock: Why is Gas so Expensive?**

Why does a supply shock impact gas prices? Changes to oil production capabilities affect the oil supply and its prices. A supply shock creates short-term or long-term changes to oil supply and prices that affect consumer spending and activity.

Editorial Team



Editor / Resort Leader

Alisa Grunert holds a M.A. in PolSci & Sociology. She is a Research Associate and doctoral candidate at the MLU Halle, where she is also part of the research group on Arms Control & Global Order (ACGO). She is a member of WIIS, WIFIS, and in the Board of MEF. Alisa aims to build bridges between IR research & society.



Editor / Group Leader

Donat Olah holds a Bachelor's degree in Applied Economics from Paris Dauphine University. He has also studied at the University of Toronto. His interests lie at the crossroads of economics, financial markets, economic policy, and global affairs.



Layout / EPIS Board – Media Design

Hanjala Tahmid is a final-year undergraduate student in Leather Engineering Department at Khulna University of Engineering & Technology in Bangladesh. His academic interests include Leather & Products Manufacturing, Footwear Engineering, Industrial Engieering. His research interest is on Footwear simulation, Medicated footwear & Leather products manufacturing.

& Contributors



Viktoria Royeck
Research Fellow



Bailey Steinmeyer
Research Fellow



Kristina Abashidze
Research Fellow



Valentin Grangier
Research Fellow



Cyprian Krystek
Research Fellow



Maximilian Strobel
Research Fellow



Matthew Malliband
Research Fellow



Martin Indjov
Research Fellow



Yann Sydow
Research Fellow



Montse Tamayo
Research Fellow



Theodor Himmel
Research Fellow



Yana Yarmolynska
Research Fellow

& Contributors



Devin Nguyen
Research Fellow

External Experts



Fabian Vetter
COO Agora Strategy Group



Nikolay Nenovsky
Member of Governing Council of the Bulgarian Central Bank

April 2026

EPIS

The EPIS Newsletter brings together the latest insights and publications from our Thinktanks, the EPIS Network, and EPIS Consult. Stay engaged and join the conversation!

Follow Us

Graduated from uni, took a new photo, or need account access?

Notify us via WhatsApp
+49 15565 975 423

Fellow of the Month



Last month saw the release of our first EPIS Report on a geographical region, led by our Fellow of the Month **Fernanda Marin**! Together with your team, you invested great effort for the first regional-focussed report of many more to come. Here is to a great first edition!

Board of Directors



Nino Bakovic has taken over the leadership role for the Geographic Report Groups in our FASP division. We further welcome **Matthias Negri** as the Geographic Working Group leader, and **Thomas Moore** as the new Denmark Chapter lead!

Board of Advisors



Dr. Ingo Friedrich is a German politician and a committed European. He previously served as the EU Parliament's Vice-President, and is currently the President of the European Economic Senate and Executive President of the Union of Medium-Sized Companies.

Interested in learning more about our board of advisors and in contributing to our work?
Become a Think Tank Fellow Now!

Viewer Stats

▲ 50,226 (+0.5%)		▲ 122 (-%)	
▲ 37,680 (+0.6%)		▲ 29 (-%)	
▲ 16,618 (+0.6%)		▲ 1,527 (-%)	

EPIS Track Record

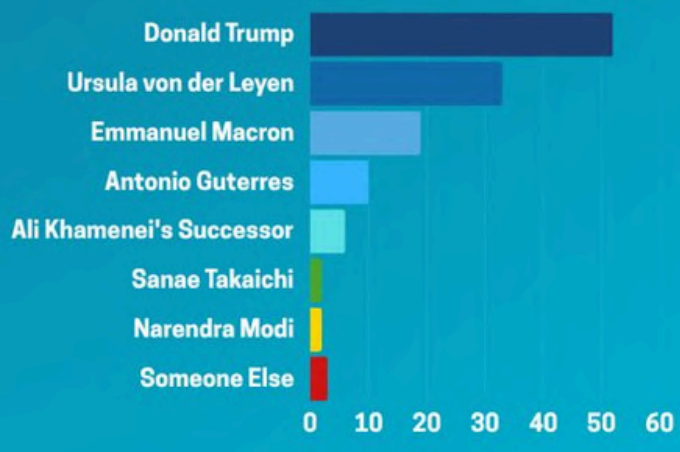
Journal Database
Accesible insights at your fingertips



EPIS App
All our work, always accesible on your phone

Question of the Month

If you could step into one world leader's shoes for a day, who would you choose?



Editorial



Editor / Report Group Leader

Donat Olah holds a Bachelor's degree in Applied Economics from Paris Dauphine University. He has also studied at the University of Toronto. His interests lie at the crossroads of economics, financial markets, economic policy, and global affairs.

EPIS Report on International Economic Relations

Dear reader,

Monetary policy in a broad sense can mean two things. First - in the common understanding - it is the set of tools used by a nation's central bank to control the money supply in a country to attain certain objectives such as price stability, low unemployment rate or economic growth. In a broader sense, it can also be a tool to attain wider, less precise objectives, such as to project power or gain diplomatic goals.

Probably, in the most recent times, the EURO is the best example as it has been created to serve a broader objective of unifying and harmonizing European economies. Despite some setbacks, notably the European Sovereign Debt crisis, it is a widely accepted and stable currency, facilitating trade between European countries and linking together the Eurozone's economies.

The United States Dollar has not been created to attain such objectives, but it was Washington which has used the Dollar for such purposes. The Dollar has been the dominant currency since the end of the Second World War. America was able to project its economic, military and diplomatic power onto the realms of monetary policy. The introduction of the EURO in 1999 has created a strong second-currency, but its adoption and importance has not come close to the dollar. Through the dollar the United States is able to project its monetary policy onto the world. The American financial system is crucial to the global economy. It is huge, free and has a robust regulatory system behind it. There were moments when trust in it was shaken, for example during the 2008 financial crisis, but it was able to come out of the crisis unscathed.

Through its currency, the United States is able to project its political will onto the world. Every major financial institution, corporation and country has ties to it. Washington can threaten or punish actors by cutting them off from the American financial system - a risk few are willing to take. However, in the last few years, a few challengers have emerged. First, cryptocurrency has been proposed as an alternative means of transacting between individuals. Its proponents have argued that being decentralized and regulated by any country could grant its holders greater freedom in transacting. Secondly, some countries have been able to evade American sanctions and create parallel systems to the current financial system. Russia, since its Invasion of Ukraine in 2022 has largely been able to continue to trade despite largely being barred from Western financial infrastructures and build out an economy which does not rely on the Dollar nor the Euro. China has developed its own proprietary payments systems to circumvent Western channels.

In this report, we will set out to explore how changes in the global financial system are playing out and what their implications are for the future.

This report came to be through the collaboration of students and young professionals from Europe and beyond, brought together by EPIS Thinktank. The variety of their views and skillsets is the fuel of the debates you will find in the pages of this report.

I would like to personally thank Nikolai Nenovsky for his guidance and his contribution to this Report. I would also like to thank Fabian Vetter for sharing their thoughts with us in this report.

Yours Sincerely,

Donát Oláh
Report Group Leader
International Economic Relations

EPIS Thinktank

Foreign Affairs & Security Policy

Recent Publications



In April, we released the second issue of the EPIS Report on Articificial Intelligence and Cybersecurity. This time, we explore cyber attacks on EU critical infrastructure and digital sovereignty. This issue also features an interview with tech pioneer Luigi Lenguito!

Give it a read on our website!

>> EPIS Reports

Recent Accomplishments

We have set up new accounts on Medium and SubStack. Follow us there and never miss a the lastest EPIS Publications!

>> Medium ***>> Substack***

Articles of the Month

EPIS Report Groups

Digital Sovereignty in a Fragmented World: Competing Models and Future Dynamics
Sofia Zanin

Agenda Shaper on Ukraine: The European Parliament's Power Bid in EU Foreign Policy
Julian Stöckle

EPIS Format Groups Magazine

EPIS Working Groups

Navigating Uncertainty: The EU's Mega-Deals in an Era of Trade Fragmentation
Roman Hanke & Lucia Almendros Zaragoza

Upcomming Publications

Next month, we will release the first issue of our EPIS Report on the Middle East and North Africa with exciting guest contributions.
Stay tuned!

EPIS Thinktank Report Groups

Join Us

Want to author the next EPIS Publication?

>> Apply for FASP Now!





Message Theodor on WhatsApp.
He will assist you :)

EPIS FASP Leader
+49 155 6597 5423
fasp[at]epis-thinktank.com

Still got Questions ?



About the Article

As in the past, the fragmentation of the global economy and the formation of geopolitical blocs inevitably lead to the emergence of monetary blocs and changes in the system of international payments and international currency. In this text, we will attempt to outline some key elements of the dynamics of these changes and the possible trajectories for the formation of a new international monetary architecture.

About the Author

Nikolay Nenovsky is a Professor of Economics at the University of Picardie Jules Verne, France, and a member of the Governing Council of the Bulgarian National Bank. His research focuses on monetary theory and history, international economics, and the history of economic thought. In 2022, he published (jointly with Eric Monnet) the book Diversity of Capitalism in Central and Eastern Europe: Dependent Economies and Monetary Regimes (Palgrave Pivot Macmillan).

As in the past, the fragmentation of the global the and the formation of geopolitical blocs inevitably lead to the emergence of monetary blocs and changes in the system of international payments and international currency. In this text, we will attempt to outline some key elements of the dynamics of these changes and the possible trajectories for the formation of a new international monetary architecture. The processes are highly complex, mainly due to the rapid development of new information technologies and artificial intelligence, and we are far from attempting precise forecasts. Rather, the aim is to present some possible trends, derived primarily from historical precedents and the international political economy of money.

Wars, Hostility, and International Currency

It should be clearly emphasized that international currency in conditions of war, hostile actions (sanctions, confiscations, and, more broadly, protectionism), and a structural rise in distrust and threats in the global economy cannot be the same as in periods of globalization, when relative stability, predictability, and general adherence to trade and monetary rules prevail.

Until recently, the presence of a hegemon and a hegemonic currency—in this case, the United States and the dollar—as well as respect for international organizations, maintained a certain stability in the system. However, especially since the arrival of the Trump administration, the situation has changed. From a universal "insurer," to whom a premium is paid for protection against risk, the United States and the dollar are increasingly becoming a source of danger and threat (Farrell and Newman, 2023).

The hostility and distrust that now dominate the international system are also shaping the transition to new systems of payments and international currency. Inevitably, the world is moving toward the formation of monetary and payment blocs within which there exists a sufficiently high level of trust, predictability, and alignment of economic and geopolitical interests. Within these blocs, payment architectures will emerge that differ from those operating between hostile blocs.

Of course, the system will be complex, forming a monetary network of states and other economic actors, with intermediary links, overlapping monetary zones, and various forms of interaction. Nevertheless, zonal development appears to be a trend that will persist for at least several decades. The national factor in shaping and controlling payment relations remains dominant, despite strong trends toward the development of private payment and digital communities. In a certain sense, these private systems can be used as part of the toolkit of state policy (for example, the encouragement of dollar-denominated stablecoins by the U.S. government as a means of redirecting public debt demand, which has been declining).

In concrete terms, the formation of a payment bloc around the BRICS countries and the states gravitating toward them in Africa and Asia is already clearly visible. A dollar bloc will also take shape around the United States and its geopolitical and geo-economic partners (in Latin America, as well as parts of Africa and Asia).

There are also grounds to expect further development of the euro area, mainly around the eurozone and other European countries (under favourable conditions, the euro payment community may expand).

In Africa, which has significant potential, the formation of a similar bloc-type payment zone is also possible. It could be structured in a way that allows greater economic autonomy for resource-rich countries, while preserving links between them and ensuring flexibility at the national level —something that is lacking in the current CFA monetary zone, as well as, to some extent, in the euro area.

This is not the place to revisit history in detail, but it is worth noting that similar bloc formations have been observed in the past during the breakdown of the global monetary system—for example, in the second half of the 19th century around the British pound (gold standard) and the French franc (the Latin Monetary Union, created as a bimetallic system), as well as in the 1930s, when the sterling, franc (linked to gold), and mark blocs emerged (the latter centered on countries with exchange controls and clearing systems).

Similar processes were also observed during the years of the Cold War, when two parallel but interwoven payment systems were formed—one based on the dollar (initially the gold-dollar standard and later the dollar standard), and the other on the Soviet ruble within the framework of the COMECON countries, as well as, to varying degrees, among the developing countries in Africa, Asia, and Latin America that gravitated toward them.

Debt-Based and Substantive International Currency

The foregoing naturally leads to the next question —namely, the nature of international money that can function in a hostile and bloc-structured world. As is well known, there is no supranational sovereignty in the international sphere; it represents an interaction among national sovereignties. For this reason, historically, forms of international money—unlike national ones (where fiat money can be imposed by some public authorities) —have always been linked to a certain value-bearing substance, such as widely traded commodities, precious metals, and above all gold. The international classical gold standard, which existed from the late nineteenth century until the First World War, represents the apogee of this system.

While in the case of national currency the detachment from material substance and the transition to fiat and debt-based forms is relatively easier due to the authority of the state, in the international sphere these processes are far more limited. They become possible only in the presence of a hegemon whose national currency is imposed and accepted by the global payment community as international money. Such a role has been played since 1974 by the US dollar, which detached itself from its gold base and became a fiat currency, whose primary guarantee lies in the ability of the United States to service its public debt and to maintain a high credit rating as a global liquidity safe haven. In other words, the rating of US government debt has come to perform a function similar to that of the price of gold in the past.

The system of hegemonic international money

has its limits, already formulated by the Polish economist Feliks Młynarski and later developed by the Belgian economist Robert Triffin. These limits are related to the necessity for the United States to maintain a deficit in its balance of payments in order to provide liquidity for expanding international transactions. This necessity, however, gradually undermines confidence in the dollar.

The significant increase in US public debt, together with the more aggressive foreign economic policy pursued in recent years and the use of sanctions as a tool of international policy, have accelerated the already ongoing processes of de-dollarization. A number of central banks and governments, especially from the BRICS countries, have reduced their exposure to US government debt. This reduction is likely more substantial than officially reported, as a significant portion of central bank reserves is not disclosed in terms of currency composition and asset types.

In conditions of rising hostility, distrust, and geopolitical conflict, market mechanisms of coordination are gradually giving way to coordination through state power, planning, and coercion.

Another important trend is also evident—private investors now hold a larger share of US debt compared to public institutions, something occurring for the first time in the history of the dollar as an international currency. At the same time, many central banks—not only from BRICS but also from the European Union—are increasing their gold reserves, and some are repatriating gold previously held in the United States and the United Kingdom. In parallel, alternative national and regional payment systems outside SWIFT are being developed, motivated by the risk of transaction blockages.

All this leads to growing distrust both toward the issuer of global money and toward the money itself—in terms of its stability, backing, and long-term reliability. In this context, the logical next step is the search for a new type of international money—one that is not purely debt-based, possesses real substantive value, and does not depend on the will of a single dominant, yet increasingly unpredictable, hegemon.

Various alternative monetary architectures can be envisaged. In conditions of rising hostility, distrust, and geopolitical conflict, market mechanisms of coordination are gradually giving way to coordination through state power, planning, and coercion. The key question is how far from this substitution of market processes can go and what its long-term consequences will be.

Regional Monetary Systems and Clearing

First, these architectures are likely to be multi-layered, with regional, bloc-based monetary systems acting as central nodes within the network. They may initially be developed in the form of bilateral, and subsequently multilateral, clearing mechanisms. Clearing is a system widely used in the past that makes it possible to reduce the need for monetary transfers and to limit the demand for foreign exchange reserves.

In bilateral clearing, trade and financial flows are conducted in the national currencies of the respective countries, with payments recorded between central banks. In multilateral clearing, a supranational clearing institution is established, which offsets (nets) payments over a specified agreed period—monthly, quarterly, or annually.

Such mechanisms were used in the 1930s following the Great Depression (particularly by Germany), as well as during and after World War II—initially in bilateral form and later in multilateral form (for example, the European Payments Union). Clearing systems also existed within the framework of the Council for Mutual Economic Assistance—initially bilateral and trilateral, and from 1964 to 1989, multilateral.

In this direction are also the proposals of John Maynard Keynes and other leading economists during the search for an optimal international monetary system after World War II (see Faudot, 2021). In a certain sense, similar processes can already be observed—albeit inconsistently—within BRICS, where the main countries (Russia, China, India) are increasingly conducting settlements in national currencies and experimenting with multilateral offsetting of balances. Due to limited public information, these processes remain difficult to trace. It is also possible that clearing mechanisms may be used between different blocs, even under high levels of distrust and hostility.

In all cases, a key question arises regarding the nature of the money used to settle final imbalances, as well as the choice of the monetary unit used for price formation and exchange rate determination within the clearing system. This is a classic problem of clearing, and its solutions are typically determined through negotiation rather than market mechanisms.
Over long historical periods, the role of "final money" has been played by gold, by national currencies convertible into gold (such as the dollar, pound, franc, mark, and Swiss franc), as well as by non-convertible currencies (for example, the dollar after 1974 or the artificial currency "transferable ruble" within COMECON).

Under contemporary conditions, it is possible that final settlement assets may be linked to a specific commodity backing expressed in physical quantities—for example, through a basket of strategic resources and raw materials closely tied to the economic development of the respective countries or blocs. This points toward the broader concept of so-called "resource money."

The idea of resource-backed money has been considered to varying degrees by economists with different theoretical perspectives, including John Maynard Keynes, Friedrich Hayek, Milton Friedman, Jan Tinbergen, Nicholas Kaldor, and Pierre Mendès France, among others. Nevertheless, it has not been successfully implemented in practice, mainly due to the interests and resistance of the issuing states of hegemonic currencies—initially the United Kingdom, and later, to an even greater extent, the United States. (Goudriaan, 1966).

Resource-Based International Money as a Unit of Account and Final Means of Settlement

What, in general terms, are resource-based forms of money, and what characteristics do they possess that make them suitable for a world of

distrust and conflict, in which all participants seek to valorise their own resources and minimize dependence on the discretionary decisions of other states? Of course, there is no payment or monetary system that can guarantee complete security and equality among participants. In this context, however, hegemonic and purely debt-based money appears to be the most problematic option.

Resource-based money represents a form of substantive money (often referred to in the literature as "commodity money"), conceptually close to the full gold standard, but with the potential for more stable purchasing power over time. Unlike gold, whose price may be highly volatile, resource-based money is linked to a broader basket of commodities, which allows for a better smoothing of price fluctuations. It ensures a closer connection between monetary and real flows in the economy, as well as reduced opportunities for lobbying pressure from producers of a specific commodity-money.

money entitles the bearer to convert it into real resources (in general, into the corresponding basket). In this way, resources—beyond their role in production and consumption—also acquire monetary functions. Depending on the dynamics of the economy and international trade, individual resources within the basket may be monetized (converted into money) or demonetized (returned to the real economic cycle as factors of production or objects of consumption).

In concrete terms, models of resource-based money have traditionally included both agricultural commodities (wheat, cotton, tobacco, coffee, tea, timber, etc.) and non-agricultural resources (oil, coal, copper, as well as precious metals such as gold). Under contemporary conditions, the composition of such a basket would likely be different and more broadly diversified. The selection of specific commodities and their respective weights within the basket constitutes a central element of the model.

Assets	Liabilities
$S = \sum_{i}^{50} \alpha_i x_i$	R

Source: Author

Table 1. Simplified balance sheet of a resource money issuing institution

In this framework, monetary issuance is tied to a defined physical set of strategic and essential commodities included in a basket with predetermined weights. Property rights over these resources are certified through commodity certificates (receipts). This basket is granted legal monetary status, and holding resource-based

A simplified issuance balance can be presented as shown in Table 1, where α_i denote the weights of the different resources, x_i the quantities of resources in the basket (the example includes 50 resources, although in practice one could start with a smaller number), and S represents the commodity basket (the resource stock) against

which the resource-based money R is issued.

In a certain sense, resource-based money represents a return to the classical Quantity Theory of Money (MV = Py), where M is the money supply, V is the velocity of circulation, P is the price level, and y is real income (Friedman and Schwartz, 1982). In the original versions of the quantity theory, M was approximated by gold or by banknotes backed by gold (with deposits added later). In the resource money model, the aim is for M to be directly and closely linked to y through R (the resource base), so that both the money supply and real income become functions of, and strongly correlated with, the resource basket.

With regard to the functioning of the mechanism, as well as its technical details and challenges, a detailed analysis can be found in Nenovsky and Bondi (2024). Here, we simply note that the main conclusion of our research is that, under contemporary conditions, the model is technically fully feasible—unlike in the past. The ability to track resource stocks, their prices, and flows now exists in near real time and at low transaction costs. This is facilitated by the development of technologies such as big data, artificial intelligence, and digital platforms.

As an illustrative example, one may consider the BRICS group (here limited to China, Russia, and India), where it is possible to construct a resource basket including, in addition to gold, key raw materials such as oil, natural gas, ores, rare earths and strategic metals, as well as basic agricultural products (e.g., rice and cotton). These resources should reflect the economic structure of the respective zone and correspond to its main export advantages (even though, for example, China is a leading exporter of industrial goods and technology). In each specific case, a separate empirical study is required to determine the composition of the basket, the weights of its components, and the operational mechanism.

There is also interest in emerging information in the public domain regarding a possible monetary basket for final settlements among China, Russia, and India, in which gold would play a leading role, complemented by a limited number of other resources. For now, however, such information remains at the level of media reports and has not been officially confirmed.

Another illustrative example is Africa, where the topic of resource-backed money is being actively discussed. The idea of commodity (resource) money as a means of valorising natural wealth and achieving economic autonomy has a long history. It was advocated, for example, by the French politician and economist Pierre Mendès France (2007 [1974]). More recently, the African Development Bank, in cooperation with KPMG, has proposed a similar model (African Development Bank, 2025).

In our study (Nenovsky and Bondi, 2024), we develop an applied model for the Sahel countries, in which the basket includes strategic raw materials (gold and oil), valuable and strategic metals (manganese, iron, lithium, uranium), as well as agricultural commodities and products (cotton, maize, rice, peanuts). Such a basket could generate international demand for the currency of an African bloc, as it provides access to key resources. In turn, this would enable African countries to finance imports of industrial goods and technology.

Conclusion

The transition from a hegemonic to a bloc-structured monetary system and payment community, as well as from debt-based to substantive forms of international money, appears likely in the medium term. However, the specific forms and pathways of this transition remain uncertain.

In any case, a relatively peaceful transition to a new architecture—though less likely—is preferable preferable to a conflict-driven scenario. It would create conditions for limiting the risk of a complete fragmentation of the global economy and would open opportunities for the gradual restoration of more stable, predictable, and cooperative forms of interaction among states and economic blocs.

References

- African Development Bank (2025). New Mechanism for Mitigating Currency Risk to Support Africa's Energy Transition, Abidjan, African Development Bank and KPMG
- Farrell, H., A. Newman (2024). Underground Empire. How America Weaponized the World Economy, Penguin Books, London
- Faudot, A. (2021). The Keynes Plan and Bretton Woods debates: the early radical criticisms by Balogh, Schumacher and Kalecki, Cambridge Journal of Economics, 45 (4): 751-770.
- Friedman, M. (1951). Commodity-reserve currency, Journal of Political Economy, 59(3): 203-232
- Friedman, M., A. Schwartz (1982). Monetary Trends in United States and the United Kingdom, The University of Chicago Press, Chicago and London
- Goudriaan, J. (1966). Vers une technique monétaire rationnelle, Economie appliquée, 19(1): 33-76
- Graham, B. (1944). World Commodities and World Currency, McGraw-Hill, New York
- Hayek, F. (1943). A Commodity Reserve Currency, The Economic Journal, 53 (210/211): 176 - 184
- Kaldor, N. (1981). The Role of Commodity Prices in Economic Recovery, World Development, 15(5): 551-558
- Keynes, J.M. (1938). The Policy of Government Storage of Foodstuff and Raw Materials, The Economic Journal, 48(191): 449-460
- Nenovsky, N. (2025). Resource Based International Currency. A history of a Failed Consensual Idea, in: Masini, F., A. Ghosh (Eds), Bretton Woods at 80: Exposing the Crossroads of the International Economic and Monetary Architecture, Routledge, London, 7-29
- Nenovsky, N., G. Bondi (2024). A proposal for a common currency based on resources for Alliance of Sahel States. Theoretical and practical issues, BRICS Journal of Economics, 5 (3) : 107-123
- Mendes France, P. (2007 [1974]). Choisir. Une certaine idée de la gauche, Fayard, Paris



About the Article

Main question: How might the energy transition affect the role and underlying strengths of the USD as the world's reserve currency. Argument: one of the main pillars of USD dominance in global reserves is the 'petrodollar' system in which oil sales are denominated in dollars, requiring central banks to hold them in reserve. With the world increasingly less dependent on the oil trade, could this undermine the system? It may be a contributing factor to the depolarization of currency reserves

About the Author

Bailey Steinmeyer is a highly motivated international honors student studying at the Vrije Universiteit Amsterdam. he studies Business Administration with a specialization in economics & finance. Alongside this, Bailey follows a dual component of law courses focused on international and European law. Bailey has gained valuable experience in the startup ecosystem in the Netherlands working in VC and Incubators, seeking a deeper understanding of the European business and legal environment.

From Bretton-Woods to the Petrodollar: the USD as the world's reserve currency

After the ruins of the Second World War left most of Europe indebted and diminished, the United States was uniquely positioned to dictate the terms of the new global economy that would emerge after the dust had settled (McKinney, Joseph, 2014). As a result, leveraging its military and institutional strength, the US put its currency at the center of the global financial and trade systems by implementing it as the world's reserve currency, backed by the gold standard. This plan was agreed to by the Allied forces and subsequently came into effect as the Bretton-Woods system. The IMF enforced the agreement, requiring countries to peg their currencies to the USD at a rate of $35 per ounce of gold. This resulted in largely stable exchange rates during the prosperous post-war era, but came quickly to an end after the United States ditched the gold standard in 1971. Due to rampant inflation and the inability to guarantee gold reserves, the need arose for more control over monetary policy, which is impossible under a fixed exchange rate, beginning the era of the unbacked fiat dollar. This momentarily threw the global financial system into uncharted territory and uncertainty, but it was quickly remedied by an agreement between Saudi Arabia and the United States to trade oil exclusively in USD in exchange for military protection and sales to the kingdom. This agreement quickly cemented the USD as the single currency for the energy trade, providing a stable demand for dollars, allowing the now-fiat currency to retain its global reserve status. This new system came to be known colloquially as the 'Petrodollar', tying the foundational importance of the oil trade to the global economy, and the dollar's reserve status into an unbreakable bond. But how exactly does oil create dollar demand? It is not as simple as oil invoicing driving dollarization, with the emphasis falling instead on the 'petrodollar recycling' mechanism (Kopper, 2009). In this system, oil is purchased in USD, meaning that importers must hold USD reserves in order to stabilize energy prices. As a result of this dollarized trade, oil exporters end up with a massive surplus in USD, which they then 'recycle' into US assets such as treasury notes, representing over $9 trillion of US public assets (McCown et al., 2006).

Petrodollar: the system of oil invoicing, and 'recycling' of USD into US assets

A changing financial landscape: Structural strengths of the dollar and their gradual erosion

While the Bretton-Woods agreement and Marshall Plan served as the ideal catalysts for the rise of the dollar, this does not entirely explain the structural advantages keeping the dollar in this position, despite consecutive crises and monetary shocks. The three strongest forces supporting the dollar's reserve currency role are the USD's role in commodity markets, its role in trade and finance, and the unmatched liquidity and access of US financial markets. With Oil being the most prominent commodity traded in dollars, and the vast majority of agricultural and mineral exports being denominated in dollars,

attempts to use other currencies fail to displace the USD (Goldberg & Tille 2008). Additionally, the USD plays a key role in trade, even without any involvement of the United States itself, serving as a widely accepted standard to reduce exchange rate uncertainty (Gopinath 2015), with its role in bond markets and debt markets being largely similar. Lastly, the US debt and treasury markets are simply unrivaled in depth and liquidity. These factors combine to create a spiral in which, for each additional user of USD, it becomes more advantageous for all others to use it, especially in commodities trading such as oil. Despite this 'perfect storm' of monetary factors, the Dollar's dominance is still subject to competition.

going to the renminbi, and the rest to cryptocurrencies and other non-traditional currency reserves (Arslanalp et al., 2022). In an era of increasingly profit-seeking banking practices, many bankers may choose to forgo the traditional safest currency baskets in favor of slightly riskier alternatives that yield higher returns than the close-to-zero interest rates of the USD and EUR. While it seems so far that the energy transition has yet to deeply erode the dominance of the US dollar, the future may not be as certain.

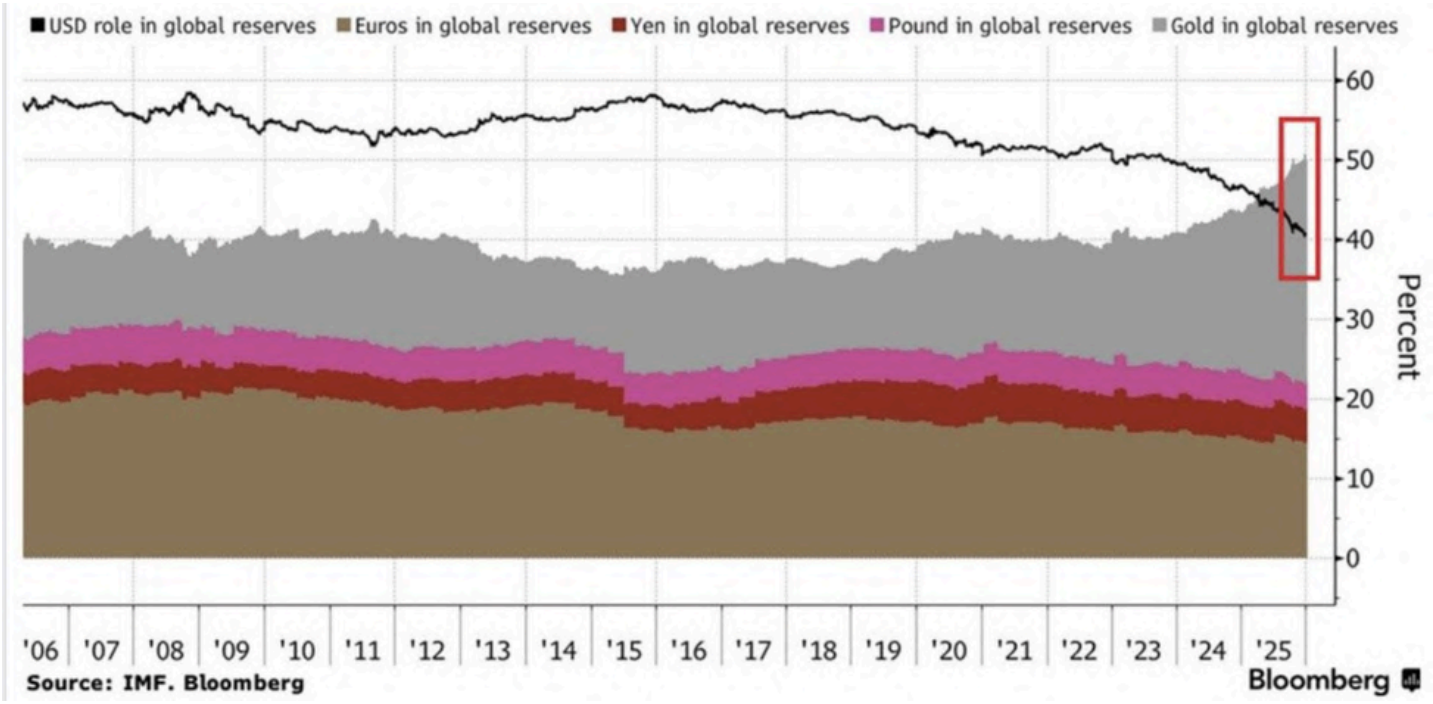


Figure 1: USD assets as a percentage of foreign exchange reserves from 2001 to 2025

Since 1999, the share of USD held in foreign reserves has fallen by roughly 12 percentage points, from 71% to 59%, representing a notable decline. This is largely the result of diversification by central bank managers away from traditional reserve currencies, with a quarter of the change

Peak oil? Commodity markets and the energy transition

Despite the increasing politicization of climate change and fossil fuel reduction, the markets are quite clear: Oil is on the way out. While for a

long time, the focus of alarm, academic and political interest was on the peak of oil production–due to its inherently finite nature–the debate has more recently shifted towards peak demand. The consensus of policy, economic, and oil industry experts has coalesced around the predicted peak between 2030 and 2035 (Delannoy et al., 2021), indicating that peak production will be due to demand constraint rather than supply. This has serious implications for the petrodollar system, as it was long held that as long as new oil was discovered and extracted, the demand for dollars would follow (Song et al., 2022). Without constant demand volumes for the USD from petroleum-importing countries, one of the strongest pillars of the USD's supremacy as the world's reserve currency might be endangered. On the other hand, while around 89% of annual oil trading volumes are in USD, this represents only around 4-5% of the total foreign exchange volume of the US Dollar (Koester et al., 2023), indicating that these fears may be overblown. While this is something that concerns US policy experts, it is a powerful motivator for many countries seeking to reduce their reliance on the US-led financial system, or ditch it outright, China being the most obvious example (Huang et al., 2026). Commodity market trading volumes have indicated that a significant share of volumes previously dedicated to petroleum are now shifting to so-called 'transition commodities' such as copper, nickel, and rare earth minerals (Akinci Tok, Şerife, 2025). The dominance of the petrodollar system was based on the fact that oil is the energy source on which society is built, but while oil's status is being challenged, the importance of energy to societal functioning remains. The shifting commodity volumes are a clear indicator that energy will remain a driving force in global trade, with traders identifying the value of minerals critical to the energy transition (transition metals) as being similar to that of crude oil.

Decentralization and De-dollarization: A Green Death Sentence?

What makes oil a commodity so special is its universal demand, fungibility, and the relative ease of its pricing on global markets. The commodity that everyone needs and will pay the same for makes a perfect candidate for the backbone of a global reserve currency, a property that renewable energy does not have. Electricity prices vary wildly from place to place and can theoretically be generated anywhere, not subject to the same laws of scarcity and centralized extraction and distribution like oil. Unlike oil, electricity cannot easily be stored and traded internationally like oil can, making it an unattractive commodity for decentralized global markets. At face value, this seems like a death sentence for the internationally integrated energy economy, which for many decades has forced countries to pursue international peace and order, allowing for a predictable and accessible global energy market. This exact principle has been the justification for the lion's share of recent US foreign interventions (in Iraq, and more recently Venezuela) and policy. If every country can decouple itself from imported oil and hence the US financial system, this would have upheaving effects on the international order. The elephant in the room must first be addressed: transition metals, such as copper, nickel, lithium, and rare-earth group metals, that are irreplaceable components in many renewable energy-generating and storing systems. While the

energy transition may reduce the single unifying commodity market that maintained dollar dominance, as is the case with oil, whoever controls the supply chains critical to energy still has immense political capital. While many of these metals exist as, if not more abundantly than oil, in a similarly vast distribution, processing, extraction, and refining have become largely concentrated in the country that seeks the end of dollar dominance the most: China

Petroyuan? The Shanghai Energy Exchange and China's Mineral Superpower Status

China has made it no secret over the last decade that it seeks to loosen the United States' grip on the global economy through its initiative, as well as various other measures to internationalize the renminbi. While past initiatives such as direct currency swaps and the petroyuan for Gulf states have sought to chip away at the USD dominance in oil markets, China's near-monopoly on critical minerals for the energy transition may prove to be a powerful source of geopolitical leverage (Taylor, 2025). In a world where local electricity prices cannot form a globalized market, the minerals needed to generate said electricity may come to serve as the new 'oil', or rather, the new standard energy commodity. The Shanghai Futures Exchange already serves as a dominant marketplace for critical transition metals, serving as a proving ground for a renminbi-priced energy commodities exchange, where over 90% of global rare-earth exchanges are priced in Yuan, with even imports (around 77% from Malaysia and Laos) being priced in Yuan as well (Rzad, 2026). Given the lack of refining and extraction capacity development in the EU and the USA, the importance of the SFE could very likely grow significantly in the coming years, resulting in widespread use of the RMB by importers of these critical minerals. The extent to which this occurs will depend heavily on how long China's dominance in these markets lasts, as well as the persistence of China's strict capital controls, which have long discouraged free use of the RMB by investors and traders, due to lack of convertibility and access (Attìlio et al., 2025).

Will the declining role of oil in international trade weaken the USD's position as the worlds reserve currency?

Implications and polarity:

While there is evidence pointing to the erosion of USD dominance in the energy trade, it must be recalled that this is merely one of the pillars of dominance that perpetuates the USD as the world's reserve currency. Many of the main factors that have perpetuated USD demand, such as unrivaled depth and liquidity of debt and assets in the USD, are not going anywhere and will not be challenged unless China significantly liberalizes its financial controls or the EU implements a fully integrated debt and capital market. At the moment, a factor that is driving governments away from holding large USD reserves is sanctions: the weaponization of the dollar by recent administrations to punish countries such as Iran and Russia has made many governments, including those close to the United States, wary of relying exclusively on the USD as a reserve currency. The fear of SWIFT controls, or freezing of assets, may prove just as big a threat, if not bigger than the de-

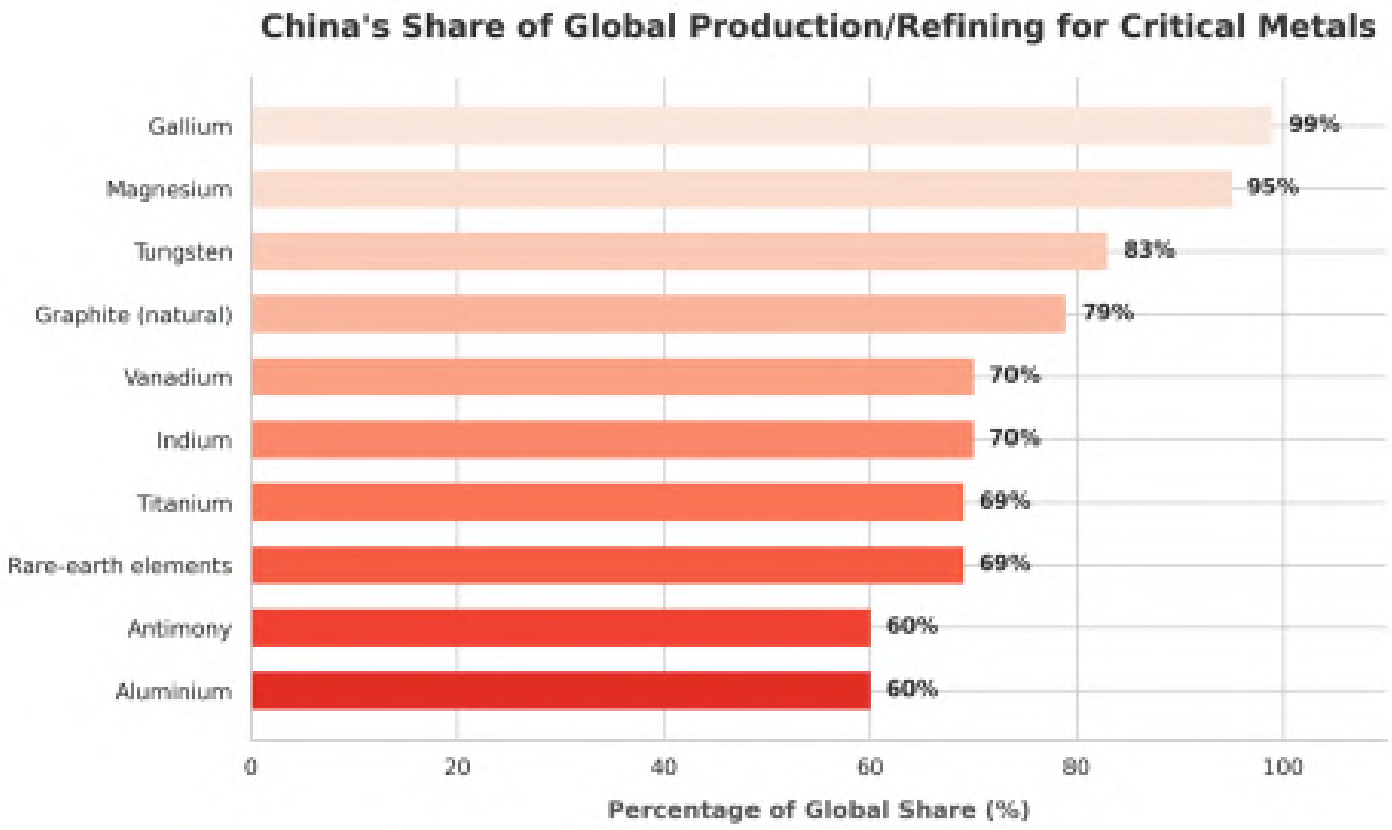


Figure 2: Share of critical transition mineral supply amongst major producers (Gaudiaut, 2024)

dollarization of the energy trade (Hefeker, Carsten, 2025). While the dollar still maintains all of its advantages in terms of financial fundamentals, the politicization of the dollar and the decentralization of global trade, particularly in energy, seem to point towards an increasingly multipolar financial system. Assuming the US doesn't default on its onerous debt in the coming years, financial dollarization will likely remain, as there are presently no viable alternatives, but alternative reserve currencies may come to comprise a larger share of holdings, with bilateral currency swaps likely becoming more common. In addition, China is in a strong position to leverage its mineral dominance to further the internationalization of the RMB, specifically in the energy trade.

So what now?

Many of these factors are clearly working against the interest of the United States, and while there are some indications that this is affecting US foreign policy specifically in the form of recent hostilities towards countries attempting to trade energy in non-dollar currencies (Venezuela, Iran, Russia, India, etc), a clear doctrine has yet to emerge. Increasing attacks on the energy transition by the Trump administration will likely further erode any advantage the US may have had in leading global markets away from oil. Still, it will be seen if its adversaries truly capitalize on this to dethrone the dollar. A major development has been the transition of the US to a net exporter of oil, becoming the 3rd largest global exporter, representing around 10% of the global market (Crude Oil: Exports | Economic Indicators | CEIC, n.d.). This represents a significant boost to the prevalence of US currency in the energy

trade, as the US is no longer entirely reliant on deals with foreign producers such as Saudi Arabia to facilitate oil pricing, as much if it can now be done through US companies. In addition, other actors like the EU are very actively seeking to reduce their reliance on imported critical minerals from China and Russia, and even the US, in the face of trade hostility, which, although long-winded, may reduce the leverage China has over Europe in this respect. In consideration of all the abovementioned factors, a dramatic collapse of dollar dominance does not seem likely, but current trends indicate a gradual transition to a more multipolar system of reserve currencies and trade denominations. But then again, only time will tell.

References

- Akinci Tok, Ş. (2025). Interplay between metal and oil markets in the renewable energy transition: An internal and external connectedness perspective. International Journal of Energy Studies. 10. 1023-1050. 10.58559/ijes.1697747.

- Attílio, L. A., Faria, J. R., & Silva, E. (2025). Critical minerals, clean tech, geopolitical risk and the global energy transition: An exploration of the Chinese influence on rare earth and lithium markets through the GVAR model. Cambridge Prisms: Energy Transitions, 1, e7. https://doi.org/10.1017/etr.2025.10005

- CEIC Data. (2026). Crude Oil: Exports | Economic Indicators |Www.ceicdata.com. https://www.ceicdata.com/en/indicator/crude-oil-exports

- Delannoy, Louis & Longaretti, Pierre-Yves & Murphy, David & Prados, Emmanuel. (2021). Peak oil and the low-carbon energy transition: A net-energy perspective. Applied Energy. 304. 10.1016/j.apenergy.2021.117843.

- Gopinath, G. (2015). "The International Price System.", NBER Working Papers 21646, Jackson Hole Economic Policy Symposium Proceedings. Federal Reserve Bank of Kansas City.

- Goldberg, L. & Tille, C. (2008). "Vehicle Currency Use in International Trade." Journal of International Economics, 76(2), 177–192.

- Koester, G., Gonçalves, E., Gomez-Salvador, R., Doleschel, J., Andersson, M., Pardo, B. G., & Lebastard, L. (2023). Inflation developments in the euro area and the United States. European Central Bank, 1(7). https://www.ecb.europa.eu/pub/economic-bulletin/focus/2023/html/ecb.ebbox202208_01%7Ec11d09d5fd.en.html#:~:text=Published%20as%20part%20of%20the

- McCown, T. A., Plantier, L. C., Weeks, J., & Department of the Treasury. (2006). PETRODOLLARS AND GLOBAL IMBALANCES. In OFFICE OF INTERNATIONAL AFFAIRS OCCASSIONAL PAPER NO. 1. https://home.treasury.gov/system/files/136/archive-documents/petrodollars.pdf

- McKinney, J. (2014). The Changing Global Economy: Roles Of The United States And The European Union In The Evolving Context. Economy of the Region. 2014. 57-68. 10.17059/2014-4-4.

- Rzad, M. (2026, January 9). Market Concentration of Rare Earth Elements: China's Dominance and the Global Response – Michigan Journal of Economics. Umich.edu. https://sites.lsa.umich.edu/mje/2026/01/09/market-concentration-of-rare-earth-elements-chinas-dominance-and-the-global-response/

- Serkan Arslanalp, Barry Eichengreen, Chima Simpson-Bell (2022). The stealth erosion of dollar dominance and the rise of nontraditional reserve currencies, Journal of International Economics, Volume 138,

- Hefeker, Carsten (2025) : Financial sanctions and the US-dollar, Vierteljahreshefte zur Arbeits- und Wirtschaftsforschung (VAW), Vol. 2, Iss. 2, pp. 197-212, https://doi.org/10.3790/vaw.2025.1457704

- Huang, L., Wang, Q., Hou, M.Z. et al. From the petrodollar to the green energy RMB: green energy–driven mechanisms and pathways for Renminbi internationalization. Carbon Neutral Syst. 2, 1 (2026). https://doi.org/10.1007/s44438-026-00022-6

- Kopper, Christopher. (2009). The Recycling of Petrodollars. Revue d'économie financière (English ed.). 9. 37-46. 10.3406/ecofi.2009.5489.

- Song, Y., Chen, B., Wang, X., & Wang, P. (2022). Defending global oil price security: Based on the perspective of uncertainty risk. Energy Strategy Reviews, 41, 100858. https://doi.org/10.1016/j.esr.2022.100858

-

- Taylor, M. (2025). Challenging Dollar Dominance? The Geopolitical Dimensions of Renminbi (RMB) Internationalisation. Journal Of Current Chinese Affairs, 54(3), 430–447. https://doi.org/10.1177/18681026251342258



About the Article

What is the future of dollar dominance? This report argues the dollar will not be displaced despite geopolitical tensions and digital innovation, due to its structural and infrastructural advantages. Instead, the system is becoming more fragmented and multipolar. By 2050, the dollar remains central but but no longer uncontested.

About the Author

Kristina is currently pursuing a Bachelor of Arts degree at the University of Nottingham. Her academic focus lies on global governance, with particular interest in how power structures influence both foreign policy and domestic political outcomes. She is driven by a broader mission to contribute to research and policy initiatives that promote ethical governance and international cooperation.

Executive Summary

The international monetary system is currently navigating a period of gradual but significant structural transformation. While the United States dollar remains the undisputed dominant currency for global reserves and financial transactions, a convergence of geopolitical tensions, technological innovation in payment systems, and strategic diversification by emerging economies is encouraging the development of alternative monetary infrastructures. These developments have intensified long-standing debates regarding whether the international financial system may eventually pivot away from its reliance on the dollar. This report evaluates the economic, technological, and geopolitical forces shaping currency competition and argues that the most plausible long-term outcome is not a sudden collapse of dollar dominance, but rather the emergence of a more fragmented and regionally differentiated financial architecture. By 2050, the global monetary system is likely to remain dollar-centred but will become increasingly multipolar, defined by parallel settlement systems and a greater role for regional currencies and digital payment technologies.

Infrastructural power: The influence derived from control over financial systems and institutions that enable global transactions, rather than currency use alone.

Historical Foundations and the Persistence of Monetary Dominance

The current hegemony of the US dollar is rooted in the institutional and geopolitical frameworks established in the wake of the Second World War. The Bretton Woods agreement of 1944 positioned the dollar as the anchor of the international monetary system, a role that was initially reinforced by the currency's convertibility to gold. Although this specific regime ended in 1971, the structural advantages underpinning US leadership persisted. Eichengreen (2011) describes this as an 'exorbitant privilege' where the US benefits from being able to borrow in its own currency while providing the world's primary reserve asset. Deep and liquid financial markets, institutional credibility, and global geopolitical influence are the three reinforcing pillars that continue to sustain this role.

The US possesses the largest and most liquid government bond market in the world, with US Treasury securities serving as the primary safe asset for global investors and central banks. The scale of these markets provides a reliable store of value that is difficult for alternative currencies to replicate. Furthermore, the US benefits from strong rule-of-law protections and a stable regulatory environment, which instill confidence in the long-term stability of the currency. These factors create powerful network effects because global trade and financial contracts are already denominated in dollars, the costs of switching to alternative infrastructures remain substantial (Gopinath, 2015). Evidence from the Bank for International Settlements (2022) confirms this persistence, noting that the dollar is involved in roughly 89% of global foreign-exchange transactions (Bank for

International Settlements, 2022). While the IMF (2024) notes that the dollar's share of global reserves has declined from approximately 70% in 2000 to roughly 58% today, this shift has been gradual and has largely benefited a range of non-traditional reserve currencies rather than a single direct competitor (International Monetary Fund, 2024).

Recent data reinforces the persistence of dollar dominance across multiple dimensions of the global financial system. According to the International Monetary Fund's COFER database, the US dollar continues to account for approximately 56-58% of global foreign exchange reserves, a decline from earlier decades but still significantly ahead of any competitor. The Bank for International Settlements reports that the dollar is involved in nearly 89% of all foreign exchange transactions, underlining its central role in global liquidity provision. Beyond reserves and trading, the dollar also dominates international debt markets and trade invoicing, particularly in commodities such as oil, which remain overwhelmingly priced in dollars regardless of the trading partners involved (Gopinath, 2015; International Monetary Fund, 2024). This broad-based dominance highlights a critical point that the dollar's role is not confined to one function but spans reserves, transactions, and financial intermediation simultaneously, making displacement structurally difficult. This gradual and broad-based diversification is illustrated in Figure 1

The US dollar remains the dominant global reserve currency, although its share has gradually declined over time, reflecting diversification into a broader set of currencies rather than the rise of a single alternative (International Monetary Fund, 2024). As shown in Figure 1, the dollar's share of global reserves has declined gradually rather than abruptly, while the absence of a clear successor currency reinforces the argument that the system is evolving through diversification rather than displacement.

The Global Architecture of International Payments

The most plausible long-term outcome is not a sudden collapse of dollar dominance, but rather the emergence of a more fragmented and regionally differentiated financial architecture.

The structural centrality of the dollar in global finance is not only reflected in reserve holdings, but also in its dominance in global currency markets. This is illustrated in Figure 2.

Understanding potential shifts in the monetary system requires a detailed examination of the infrastructure facilitating cross-border payments. Most transactions currently rely on correspondent banking networks, where banks maintain accounts with one another in major financial centers to pass instructions through intermediaries. The Society for Worldwide Interbank Financial Telecommunication (SWIFT) serves as the primary messaging system for these instructions, connecting over 11,000 financial institutions globally (SWIFT, 2024). While SWIFT does not move money itself, it provides the essential communication layer for banks to settle transactions.

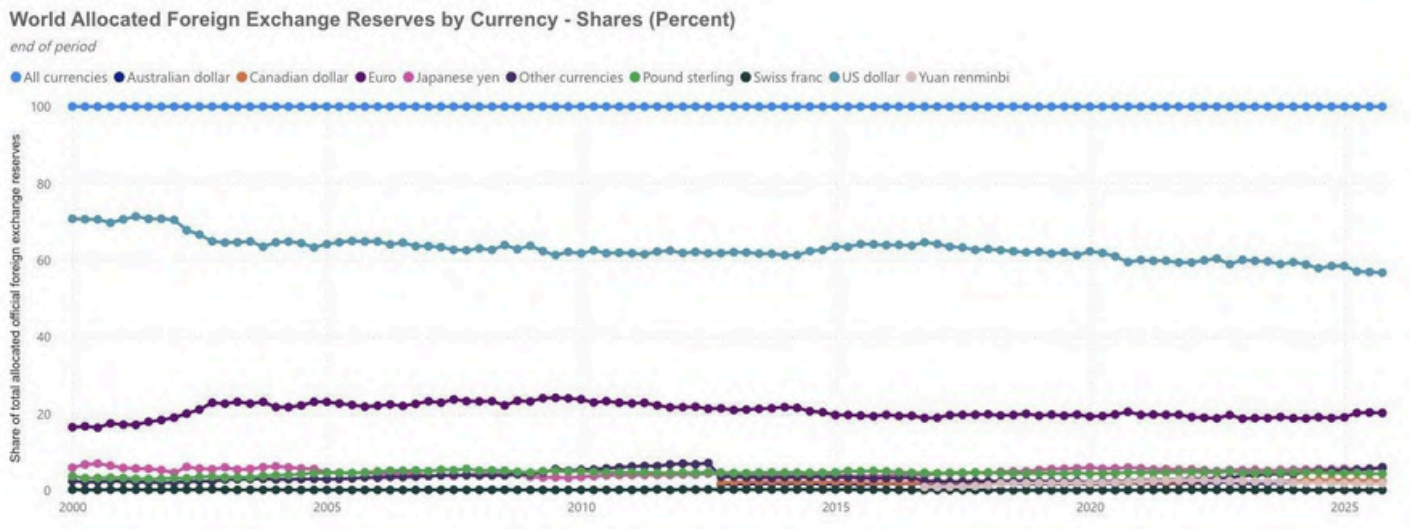


Figure 1: Global Foreign Exchange Reserve Composition, 2000-2025 (IMF)

Actual settlement often occurs through US-based systems like CHIPS or Fedwire because many international payments are denominated in dollars. Consequently, a significant portion of global financial activity passes through US infrastructure even when the transacting parties are located outside the United States. This structural dependence reinforces the dollar's central role, as alternative systems must not only create messaging protocols but also provide the underlying liquidity and clearing capacity that the US currently offers. As Prasad (2021) notes, the digital revolution is transforming these processes, but the institutional weight of existing networks remains a formidable barrier to entry for new competitors (Prasad, 2021).

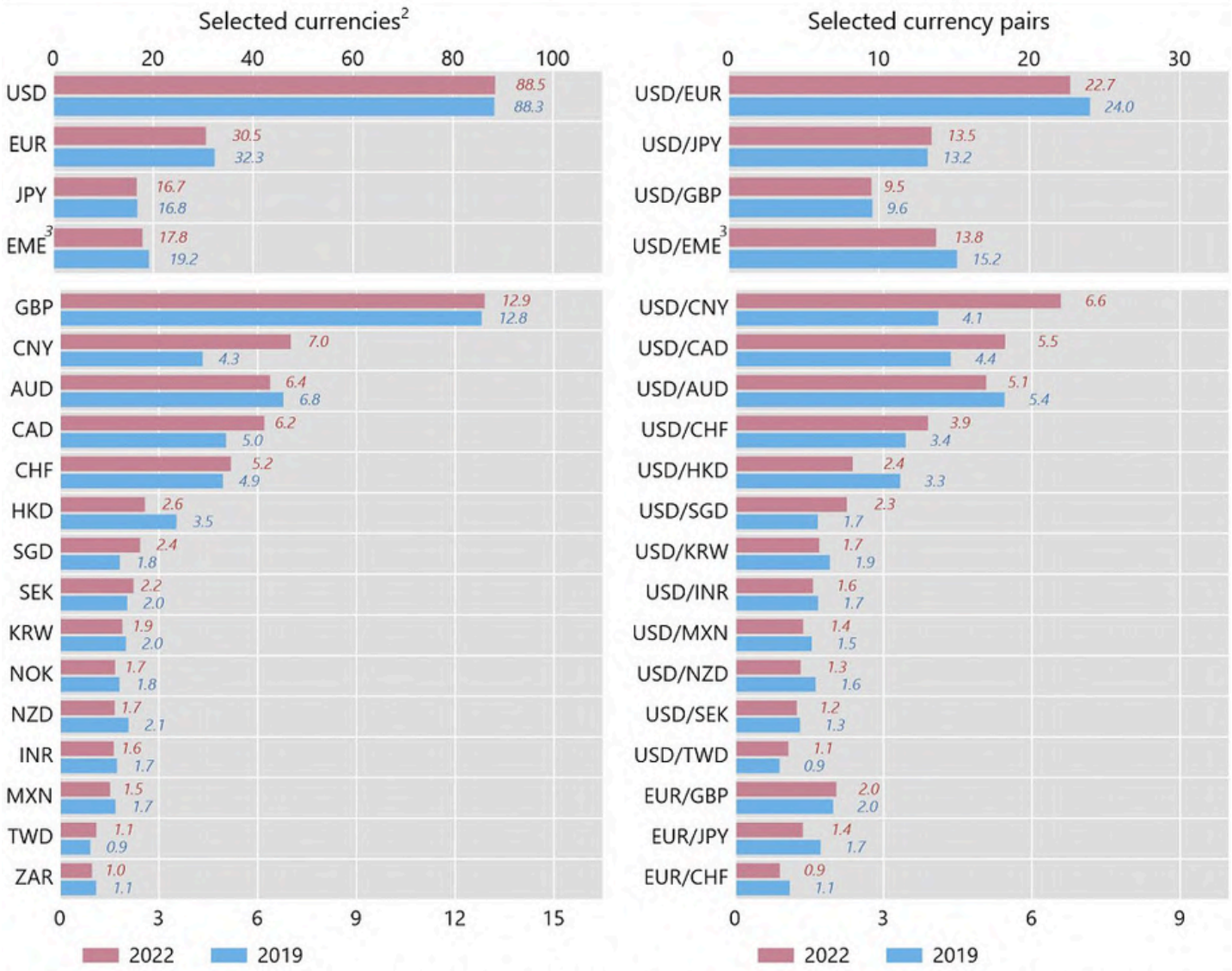
A key limitation in debates surrounding currency competition is the tendency to focus on currencies themselves rather than the infrastructures through which they operate. The dominance of the dollar reflects not only its widespread use as a medium of exchange, but its deep integration into the institutional architecture of global finance. This infrastructural centrality creates a form of power that is significantly more difficult to replicate than currency usage alone. Even where alternative currencies gain traction in specific contexts, they often continue to rely on elements of the existing system, such as SWIFT messaging or dollar-based clearing networks. Consequently, any meaningful shift in the international monetary system would require not only a change in currency preferences but a transformation of the underlying financial infrastructure, a process that is inherently slow and complex. However, it is important to note that infrastructures such as SWIFT are not inherently tied to the dollar itself. In principle, these systems could continue to operate under alternative currency configurations, facilitating transactions in euros, renminbi, or other currencies. The persistence of dollar dominance therefore reflects not only infrastructural centrality, but also the continued preference for dollar-denominated liquidity, assets, and financial contracts.

Geopolitical Tensions and the 'Weaponisation' of Finance

In recent years, geopolitical tensions have introduced political considerations into financial infrastructure previously perceived as neutral. Economic sanctions have increasingly focused on

Foreign exchange market turnover by currency and currency pairs[1]

Net-net basis, daily averages in April, as a percentage of total turnover — Graph 4



[1] Adjusted for local and cross-border inter-dealer double-counting, ie "net-net" basis. [2] As two currencies are involved in each transaction, the sum of shares in individual currencies will total 200%. [3] Emerging market economy currencies excluding the Chinese renminbi and Russian rouble: AED, ARS, BGN, BHD, BRL, CLP, COP, CZK, HKD, HUF, IDR, ILS, INR, KRW, MXN, MYR, PEN, PHP, PLN, RON, SAR, SGD, THB, TRY, TWD and ZAR.

Source: BIS Triennial Central Bank Survey. For additional data by currency and currency pairs, see Tables 4 and 5. See our Statistics Explorer for access to the full set of published data.

© Bank for International Settlements

Figure 2: Currency Distribution of Global Foreign Exchange Market Turnover The US dollar is involved in nearly 90% of global foreign exchange transactions, highlighting its central role in global liquidity provision (Bank for International Settlements, 2022). As shown in Figure 2, the dollar's dominance extends beyond reserves into the core functioning of global financial markets, reinforcing its central role in cross-border payments and liquidity provision.

controlling payment networks and reserve assets. The freezing of Russian central bank reserves in 2022 and the removal of major Russian banks from SWIFT demonstrated the strategic power inherent in global financial infrastructure. These actions have prompted several governments to explore ways to reduce their dependence on Western-dominated systems and diversify their

financial relationships to mitigate 'sanction risk'.

Strategic rivalry between the United States and China has also extended into financial technology and global standards. China has promoted alternative systems such as the Cross-Border Interbank Payment System (CIPS) to facilitate the international use of the renminbi. While CIPS is growing, Zhang and Chen (2023) highlight that it currently functions more as a supplementary infrastructure than a total replacement, as a large portion of its transactions still rely on SWIFT for messaging. The potential for a 'bifurcated' global financial system, one centered on the dollar and another on the renminbi, is a subject of intense academic and policy debate. Tooze (2018) observes that the legacy of the 2008 financial crisis already strained the global consensus on dollar-centric stability, and current geopolitical fragmentation is accelerating these fissures (International Monetary Fund, 2023).

Digital Innovation: CBDCs and the New Settlement Frontier

Technological innovation, particularly in Central Bank Digital Currencies (CBDCs), represents the most significant potential shift in how international payments are settled. CBDCs are digital versions of sovereign currencies issued directly by central banks, designed to improve settlement speed and reduce transaction costs. Beyond China's e-CNY, the European Central Bank (2023) is investigating a digital euro, and the Bank for International Settlements (2024) is coordinating cross-border settlement experiments like Project mBridge. These technologies could theoretically allow for 'atomic settlement', the near-instantaneous exchange of assets, without relying on traditional correspondent banking networks. If successful, multi-CBDC platforms could bypass the need for a single dominant vehicle currency like the dollar for certain trade corridors. However, significant technological, regulatory, and interoperability challenges remain. As the BIS (2023) points out, the 'unbundling' of money and its traditional functions through digital means does not automatically translate into the displacement of the dollar's role as a store of value. Digital innovations are more likely to coexist as alternative settlement mechanisms within a more complex, layered financial system rather than providing a singular replacement for the dollar.

The BRICS Bloc and the Limits of Monetary Cooperation

Discussions regarding a shared BRICS currency have gained political visibility, driven by a desire among emerging economies to reduce dollar reliance. However, such proposals face immense structural obstacles. Cohen (2015) argues that currency power is derived not just from economic size but from the quality of institutions and the ability to provide a 'safe haven' during crises. The BRICS nations differ significantly in their exchange-rate regimes, capital-control frameworks, and inflation histories. A successful international reserve currency requires deep financial markets and a vast supply of safe assets, criteria currently met only by the United States and, to a lesser extent, the Eurozone. Because of these constraints, a unified BRICS currency is unlikely in the medium term. Instead, cooperation is focusing on more realistic, incremental developments. This includes the increased use of local currencies in bilateral trade, the expansion of financing through the

New Development Bank, and greater coordination between national payment systems. These efforts contribute to a more multipolar landscape but do not fundamentally challenge the dollar's role as the primary global safe asset. The IMF (2023) suggests that while these regional initiatives are significant, they often complement rather than replace the broader global financial architecture (Eichengreen, Mehl and Chitu, 2018).

De-dollarisation: Limits and Misconceptions

The concept of 'de-dollarisation' has gained increasing prominence in both policy and academic debates in recent years. Despite increasing political rhetoric surrounding 'de-dollarisation', the concept often overstates the scale and speed of structural change within the international monetary system. While some countries have sought to reduce exposure to dollar-based systems, this has not translated into a systemic shift away from dollar usage. In practice, the dollar remains deeply embedded in global trade invoicing, financial contracts, and debt markets. Even economies advocating diversification, including China, continue to hold substantial dollar-denominated assets, reflecting the absence of viable alternatives at scale. Structural constraints further limit transition that competing currencies lack the liquidity, institutional credibility, and convertibility required to function as global safe assets. As a result, current trends are better understood as diversification within a dollar-centred system rather than a coherent move toward its replacement. The persistence of these structural barriers suggests that de-dollarisation is likely to remain partial, uneven, and politically driven rather than economically transformative. Even in the absence of a direct replacement, a gradual dilution of dollar usage could still have meaningful implications for global financial stability, particularly by reducing the efficiency of unified liquidity networks and increasing transaction costs across fragmented systems.

Macroeconomic Implications of Dollar Centrality

The dollar's role as the global unit of account provides the United States with significant macroeconomic advantages, but it also creates vulnerabilities for the global economy. When the Federal Reserve adjusts interest rates, the effects are felt globally through changes in the cost of dollar-denominated debt and shifts in exchange rates. This 'Global Financial Cycle' means that many countries must align their domestic monetary policies with US conditions to maintain financial stability (Rey, 2013). Furthermore, the prevalence of dollar invoicing in international trade means that fluctuations in the dollar's value have a disproportionate impact on global trade volumes and inflation. Amiti, Redding, and Weinstein (2019) have shown how trade disruptions and policy uncertainty can lead to higher prices and reduced welfare, highlighting the risks inherent in a highly centralised system. As other economies grow and develop more sophisticated financial markets, the pressure to move toward a system that is less sensitive to US domestic policy is likely to increase.

Economic Consequences of Monetary Fragmentation

The trend toward a 'layered' monetary system, where alternative networks like CIPS or Russia's

SPFS coexist with SWIFT, suggests a future of fragmentation. While this may increase resilience for specific nations by providing alternatives during geopolitical conflicts, it also carries economic costs. Segmented payment systems likely lead to higher transaction costs, as financial institutions may need to hold liquidity in multiple currencies and maintain access to various infrastructures. This duplication of effort increases operational burdens for both banks and multinational corporations. At the same time, large financial institutions may act as a stabilising force against excessive fragmentation. As segmentation increases operational complexity and cost, banks and multinational firms have strong incentives to preserve interoperability across payment systems, thereby reinforcing elements of the existing global financial architecture. Furthermore, fragmentation could lead to greater exchange-rate volatility and the regionalisation of capital flows. Investment patterns may increasingly align with geopolitical partnerships rather than purely economic considerations. The IMF (2024) warns that such fragmentation could reduce global economic growth by hindering the efficient allocation of capital across borders. The challenge for policymakers in the coming decades will be to manage these pressures while maintaining the benefits of a relatively integrated global financial system.

Recent developments provide concrete examples of how monetary fragmentation is unfolding in practice. Following the imposition of Western sanctions in 2022, Russia significantly increased its use of alternative currencies, particularly the Chinese renminbi, in trade settlements, while expanding reliance on domestic financial infrastructure such as SPFS. China, for its part, has promoted renminbi usage through bilateral agreements and initiatives linked to the Belt and Road Initiative, including limited experiments with yuan denominated energy transactions. India has also explored rupee-based trade settlement mechanisms, particularly in transactions with sanctioned economies, reflecting a broader trend toward local-currency experimentation. Meanwhile, the European Union has renewed efforts to strengthen the international role of the euro, particularly in response to geopolitical vulnerabilities exposed by the Ukraine war. These cases illustrate that while alternative mechanisms are expanding, they remain regionally concentrated and function primarily as supplements rather than substitutes for the dollar-based system.

The Euro and the Renminbi: Regional Leaders or Global Contenders?

For a currency to challenge the dollar's global role, it must offer a comparable level of liquidity, stability, and institutional backing. The Euro remains the second most important currency globally, benefiting from a large integrated economy and high-quality institutions. However, the lack of a single unified safe asset, equivalent to the US Treasury bond, limits its ability to fully compete as a global reserve currency. The European Central Bank's work on the digital euro is partly aimed at bolstering the currency's international role in a digital age. The Renminbi's rise is driven by China's dominant role in global trade and the government's efforts to internationalise the currency. While its use in trade settlement is growing, its role as a reserve asset and financial currency is constrained by China's capital controls and less transparent

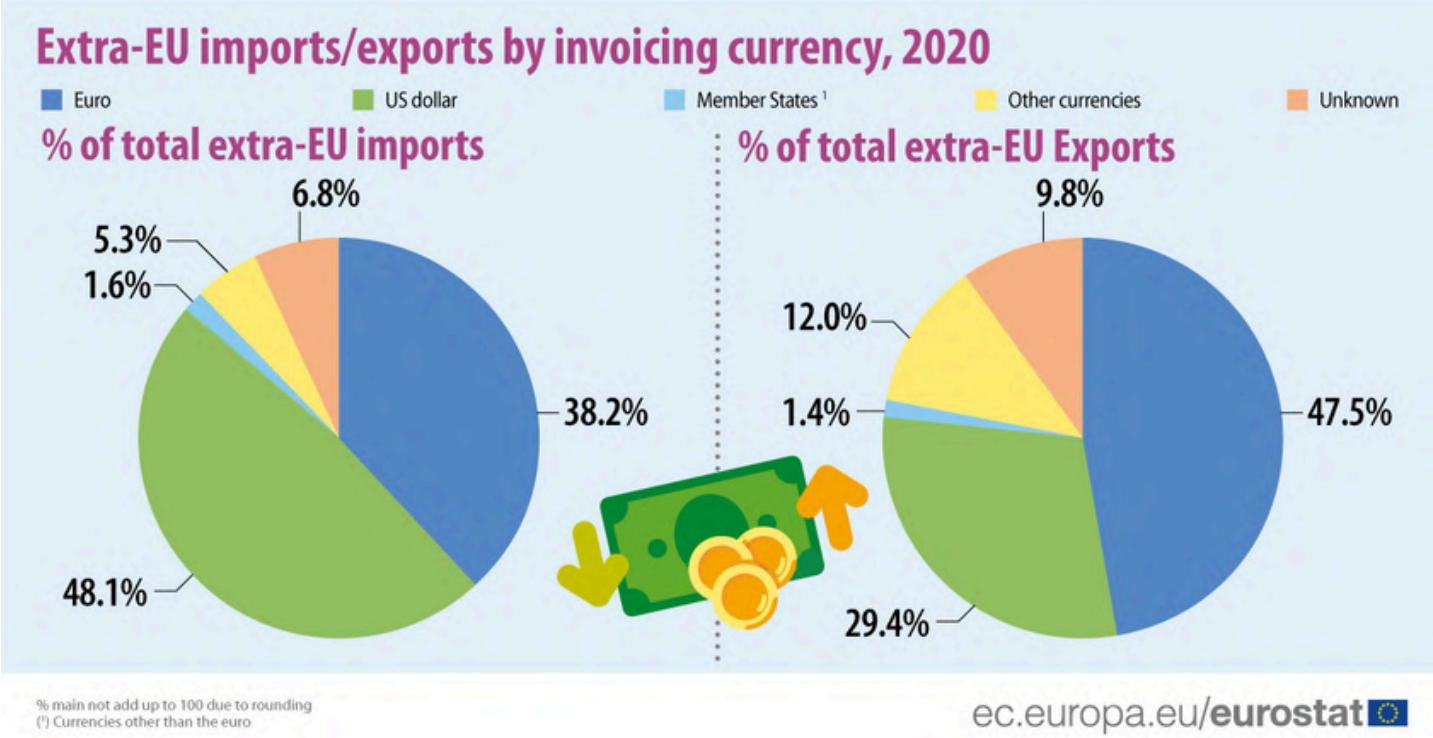


Figure 3: Currency composition of trade invoicing illustrates the coexistence of regional currencies alongside continued dollar dominance (Eurostat, 2020).

financial markets. As Eichengreen, Mehl, and Chițu (2018) observe, the transition to a multipolar system is often slow and dependent on the

Recent developments provide concrete examples of how monetary fragmentation is unfolding in practice. Following the imposition of Western sanctions in 2022, Russia significantly increased its use of alternative currencies, particularly the Chinese renminbi, in trade settlements, while expanding reliance on domestic financial infrastructure such as SPFS. China, for its part, has willingness of the challenging nation to provide the necessary global public goods, such as open capital accounts.

Scenarios for 2050: A Multipolar Future

As the global monetary system evolves toward 2050, three primary scenarios emerge. The first is continued dollar centrality, where persistent network effects and unmatched market depth keep the dollar dominant despite the rise of digital and regional alternatives. In this scenario, the dollar remains the 'indispensable' currency, even if its relative share of transactions declines slightly. The second is a truly multipolar system where the euro and renminbi take on much larger roles in trade invoicing and reserve holdings, leading to a 'tripolar' arrangement. The third scenario involves the development of fragmented financial blocs with limited interoperability. This would represent a departure from the post-Cold War era of globalisation, with separate technological and regulatory standards governing Western and non-Western financial spheres. Current trends suggest a future that blends these scenarios into a system that remains anchored by the dollar for high-value finance and safe assets but is increasingly multipolar in trade settlement and technologically diversified through CBDCs and regional payment bridges.

Conclusion and Strategic Policy Implications

Predictions of an imminent dollar collapse often underestimate the structural foundations and network effects of the current system. Deep capital markets, strong legal institutions, and a history of transparency continue to support the dollar's central role. However, the period of 'uncontested' dominance is likely ending. Technological innovation and geopolitical competition are gradually reshaping the global financial infrastructure, providing nations with a broader range of available settlement mechanisms.

For the United States, maintaining the dollar's status will require a focus on institutional credibility, fiscal sustainability, and the strategic, rather rather than reflexive, application of financial sanctions. For the global community, the rise of alternative systems offers the promise of greater resilience but the risk of increased costs and reduced efficiency. By 2050, the global monetary system will likely be characterised by a complex balance: the dollar will remain the primary reserve currency, but it will operate within a much more diverse ecosystem of digital platforms and regional currencies, reflecting a world that is more economically multipolar and technologically advanced. The question is no longer whether the dollar will remain dominant, but how far fragmentation can proceed without undermining the efficiency of the global financial system itself.

References

- Amiti, M., Redding, S. and Weinstein, D. (2019) 'The Impact of the 2018 Trade War on U.S. Prices and Welfare', Journal of Economic Perspectives, 33(4), p. 187-210
- Bank for International Settlements (2022) Triennial Central Bank Survey of Foreign Exchange and OTC Derivatives Markets. Basel: BIS
- Bank for International Settlements (2023) Annual Economic Report 2023. Basel: BIS
- Bank for International Settlements (2024) Project mBridge: Connecting Economies Through CBDC. Basel: BIS Innovation Hub
- Cohen, B. (2015) Currency Power: Understanding Monetary Rivalry. Princeton: Princeton University Press
- Eichengreen, B. (2011) Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System. Oxford: Oxford University Press
- International Monetary Fund (2024) World Economic Outlook. Washington, D.C.: IMF
- Prasad, E. (2021) The Future of Money: How the Digital Revolution Is Transforming Currencies and Finance. Cambridge, MA: Harvard University Press
- SWIFT (2024) SWIFT Annual Review. Brussels: SWIFT
- Tooze, A. (2018) Crashed: How a Decade of Financial Crises Changed the World. London: Allen Lane
- Zhang, C. and Chen, H. (2023) 'China's Cross-Border Interbank Payment System and the Future of Renminbi Internationalisation', Journal of International Economic Policy, 15(2), p. 89-108
- Eichengreen, B., Mehl, A. and Chițu, L. (2018) How Global Currencies Work: Past, Present and Future. Princeton: Princeton University Press

- European Central Bank (2023) Towards a Digital Euro: Progress on the Investigation Phase. Frankfurt: ECB
- Federal Reserve (2025) The International Role of the U.S. Dollar. Washington, D.C.: Federal Reserve Board
- Gopinath, G. (2015) 'The International Price System', NBER Working Paper No. 21646
- International Monetary Fund (2023) Global Financial Stability Report. Washington, D.C.: IMF
- International Monetary Fund (2024) Currency Composition of Official Foreign Exchange Reserves (COFER). Washington, D.C.: IMF

EPIS Thinktank

Foreign Affairs & Security Policy

Recent Publications



In April, we released the second issue of the EPIS Report on Articificial Intelligence and Cybersecurity. This time, we explore cyber attacks on EU critical infrastructure and digital sovereignty. This issue also features an interview with tech pioneer Luigi Lenguito!

Give it a read on our website!

>> EPIS Reports

Recent Accomplishments

We have set up new accounts on Medium and SubStack. Follow us there and never miss a the lastest EPIS Publications!

>> Medium ***>> Substack***

Articles of the Month

EPIS Report Groups

Digital Sovereignty in a Fragmented World: Competing Models and Future Dynamics
Sofia Zanin

Agenda Shaper on Ukraine: The European Parliament's Power Bid in EU Foreign Policy
Julian Stöckle

EPIS Format Groups Magazine

EPIS Working Groups

Navigating Uncertainty: The EU's Mega-Deals in an Era of Trade Fragmentation
Roman Hanke & Lucia Almendros Zaragoza

Upcomming Publications

Next month, we will release the first issue of our EPIS Report on the Middle East and North Africa with exciting guest contributions.
Stay tuned!

EPIS Thinktank Report Groups

Join Us

Want to author the next EPIS Publication?

>> Apply for FASP Now!





Message Theodor on WhatsApp.
He will assist you :)

EPIS FASP Leader
+49 155 6597 5423
fasp[at]epis-thinktank.com

Still got Questions ?



About the Article

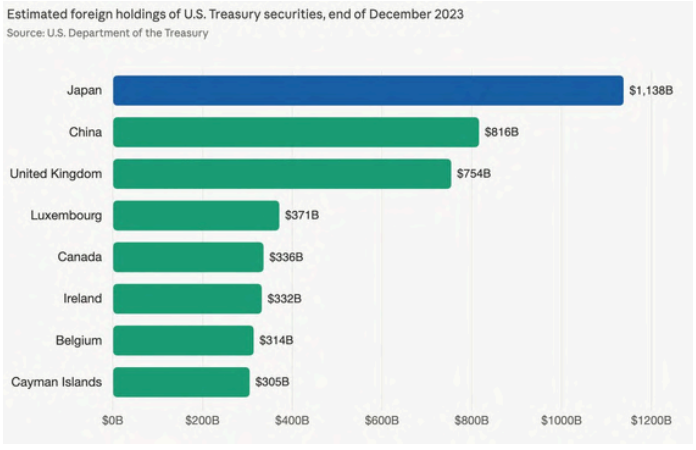
Q: Does Japan's dollar exposure prevent the BoJ from raising rates? Arg: Low rates fuel carry trades that weaken the yen, while $1T+ in U.S. Treasuries ties Japan to U.S. monetary cycles — a self-reinforcing trap. Concl: Gradual normalisation is the best exit, but political pressures keep the status quo attractive.

About the Author

Valentin Grangier is a French student of International Relations at Leiden University, currently on exchange at the University of Tokyo. Specialising in East Asia and the Indo-Pacific, he focuses on geopolitics, security, and regional dynamics, analysing power interplay, ASEAN's role, and shifting alliances. Passionate about Japan and proficient in intermediate Japanese, he blends constructivist, realist, liberal, and democratic perspectives to explore the region's political, economic, and security challenges.

Introduction

Japan's economy is caught in a difficult position. Growth has remained stubbornly low, public debt has climbed above 250% of GDP, and the Bank of Japan (BoJ) has kept interest rates near zero for the better part of three decades (Shiratsuka, 2025). The result is a yen that has been structurally weak against most major currencies for years. That weakness has a silver lining for Japanese exporters, but it has also turned Japan into the world's preferred funding currency for carry trades, a strategy in which investors borrow cheaply in yen and deploy those funds into higher-yielding assets abroad (Fong, 2010; Hattori & Shin, 2009). At the same time, Japan has quietly accumulated over one trillion dollars in U.S. Treasury securities, making it the single largest foreign holder of American government debt (Statista, 2024). Together, these two facts have locked Japan into what this paper calls a "weak yen trap," a situation where the policy options available to the BoJ are far narrower than they appear.



Source: U.S. Department of the Treasury. (2023). Treasury International Capital (TIC) System: Foreign holdings of U.S. securities. Retrieved from https://home.treasury.gov/data/treasury-international-capital-tic-system

This paper explores how persistently low rates feed carry trades that keep the yen depressed, while Japan's enormous Treasury portfolio ties it tightly to movements in U.S. monetary policy (Jiang et al., 2024; McKinnon, 2012). Yield curve control deepened this bind by artificially suppressing rates even as inflation began to stir globally (Shiratsuka, 2025). History offers a warning: previous episodes of carry trade unwinding, most notably during the subprime crisis, sent shockwaves through global financial markets (Hattori & Shin, 2009).

This raises the central question driving the paper: Does Japan's massive dollar exposure prevent the Bank of Japan from raising interest rates? Carry trades thrive precisely because rates stay low (Fong, 2010), and Japan's Treasury holdings mean any shift in U.S. policy cycles directly feeds back into Japanese balance sheets, making tightening at home an especially fraught proposition (Jiang et al., 2024; Statista, 2024).

The paper proceeds as follows. Section 1 lays out the theory of carry trades and global financial cycles. Section 2 reviews BoJ policy, with particular attention to how yield curve control worked in practice. Section 3 examines yen carry trade dynamics. Section 4 unpacks Japan's Treasury holdings and the institutional exposures that often go undiscussed. Section 5 assembles the full trap mechanism. Section 6 considers the risks this poses both globally and for the Japanese economy itself.

Main Body

Japan's prolonged low-interest-rate policy and massive U.S. Treasury holdings create a tight bind for the Bank of Japan. Low rates fuel yen

carry trades that weaken the currency further, while dollar assets expose Japan to U.S. policy shifts. This "weak yen trap" makes tightening policy risky. The core question is: Does Japan's dollar exposure hold back the Bank of Japan from raising rates?

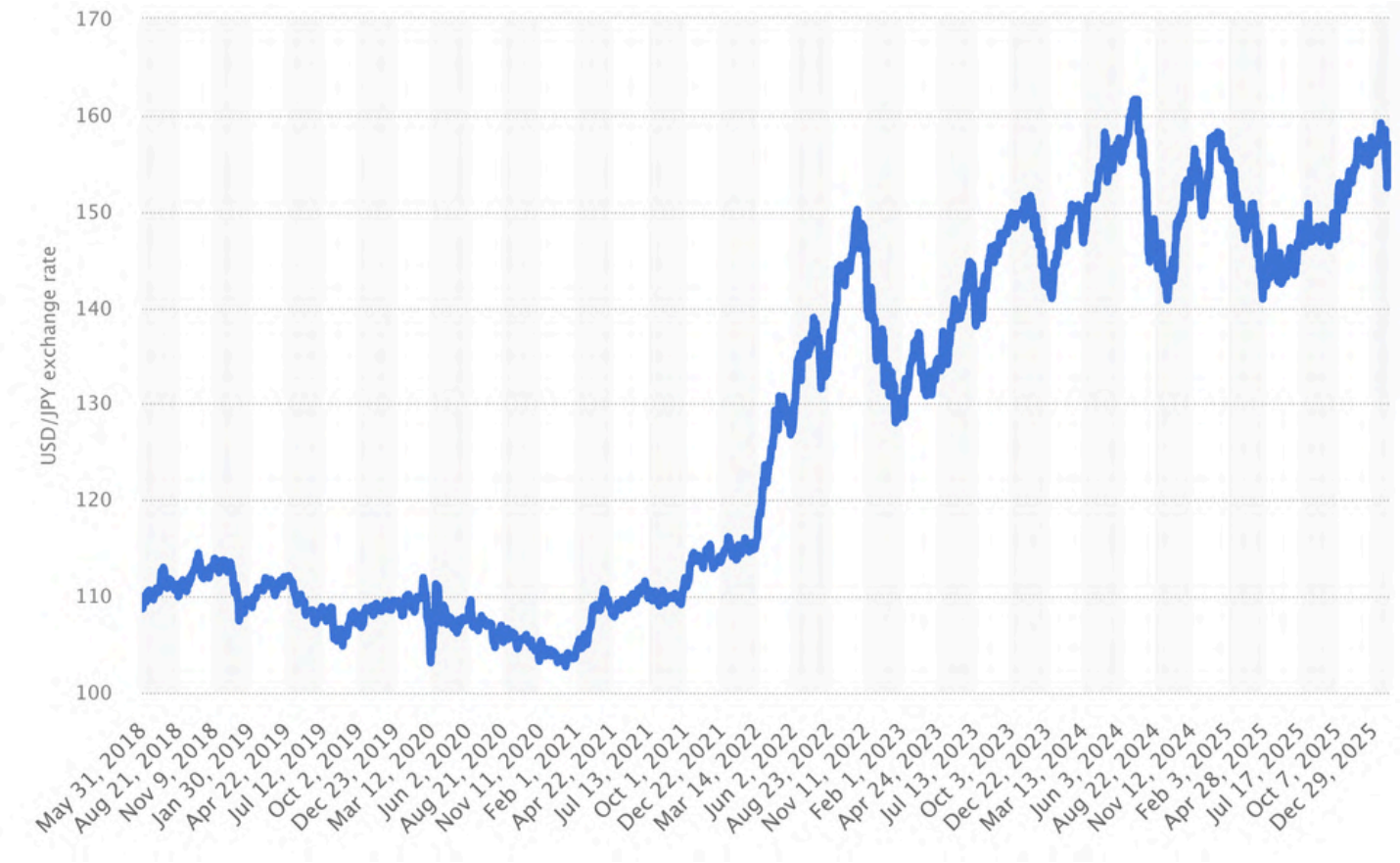


Figure 2: USD/JPY FX rate, up to Feb 5, 2026

1. Carry Trades and Global Financial Cycles

Carry trades work by exploiting interest rate gaps between currencies. The basic mechanics are simple. An investor borrows in a low-interest-rate currency, the yen in this case, then converts that loan into a higher-yielding currency such as the U.S. dollar or an emerging market currency. The investor then parks the converted funds in higher-return assets abroad and pockets the difference between the low borrowing cost in yen and the higher return earned elsewhere. Because this process requires selling yen to buy foreign currency, it puts constant downward pressure on the yen's exchange rate (Fong, 2010). And the weaker the yen gets, the cheaper it becomes to repay the original yen loan in real terms, which makes the trade even more attractive and draws in more participants, reinforcing the cycle.

Across different market conditions, yen carry trades have historically delivered strong risk-adjusted returns, even after accounting for the occasional sharp reversal (Fong, 2010). The persistent interest rate differentials that make

these trades possible have long prompted calls for international monetary reform to address the resulting imbalances (McKinnon, 2012).

Japan's centrality to global carry dynamics became impossible to ignore during the subprime crisis. Yen-funded leverage had built up extensively through banks and broker-dealers. When risk sentiment soured, carry positions unwound rapidly. Investors rushed to sell their foreign holdings, convert the proceeds back into yen, and close out their loans. The sudden surge in yen demand pushed the currency up sharply within a matter of weeks, compressing broker-dealer balance sheets and contributing to the broader market sell-off (Hattori & Shin, 2009). Carry trades, it turned out, were not just passive bets on interest rate differentials; they were amplifiers of global financial stress.

Petrodollar: the system of oil invoicing, and 'recycling' of USD into US assets

An additional layer comes from the role of U.S. Treasuries as the world's premier safe asset. Foreign demand for Treasuries links holders to the global financial cycle in ways that constrain their own monetary autonomy. When U.S. financial conditions tighten, the effects ripple outward, shaping risk appetite and funding conditions even in countries with their own independent currencies (Jiang et al., 2024). Japan sits squarely at this intersection, functioning simultaneously as the world's leading carry funding currency and one of its largest Treasury holders.

2. Bank of Japan Policy, Yield Curve Control, and the Weak Yen

The Bank of Japan anchored its ultra-loose stance through a policy called yield curve control (YCC), which ran from 2016 to 2024. To appreciate why this mattered so much, it helps to understand how YCC differed from conventional monetary policy. Under a normal framework, a central bank sets a short-term interest rate and allows longer-term rates to be determined by the bond market. YCC went considerably further. The BoJ set an explicit target for the yield on 10-year Japanese Government Bonds (JGBs), keeping it pinned near zero per cent. To enforce that target, the BoJ committed to buying unlimited quantities of JGBs whenever yields threatened to rise above the cap. In effect, it became the dominant and at times only meaningful buyer in the Japanese bond market.

By suppressing borrowing costs across the entire yield curve rather than just at short maturities, YCC guaranteed cheap credit at every horizon. This kept Japanese rates well below those of the United States and other major economies (Shiratsuka, 2025) and widened the interest rate differentials that make carry trades so profitable. The BoJ's bond purchases became so large in scale that it eventually held the majority of all outstanding JGBs, illustrating just how deeply the policy warped normal market functioning.

In the short run, low rates and a weak yen supported Japanese exports. But the policy also entrenched Japan's status as a funding currency. Markets came to expect the BoJ to stay accommodative indefinitely, which widened interest gaps further and invited even more carry trade activity (Fong, 2010). When inflation finally picked up globally after 2021, the BoJ

was slow to respond, partly because it was locked into YCC commitments that were difficult to exit without triggering sharp yield spikes and significant losses on its own bond holdings (Shiratsuka, 2025). Staying in the trap had become, paradoxically, the path of least resistance (McKinnon, 2012).

3. Yen Carry Trade Dynamics

Yen carry trades tend to follow a recognisable pattern: slow, steady gains during periods of calm, followed by sudden and severe reversals when sentiment shifts. Research confirms that yen carry strategies have historically outperformed simple benchmarks across different risk environments, suggesting the premium on offer is genuine and not just compensation for tail risk (Fong, 2010). Low volatility and the market's confidence in continued BoJ accommodation make yen borrowing a reliable foundation for leverage.

Carry trades thrive on interest rate gaps: investors borrow cheaply in yen, convert to higher-yielding currencies, and pocket the difference — keeping constant downward pressure on the yen

The subprime episode remains the clearest demonstration of what happens when the music stops. Carry positions had accumulated steadily through the first half of 2007, channelled through banks that were intermediating funds into riskier assets. The unwind, when it came in August 2007, was swift and brutal. The yen rose roughly 10% over just a few weeks, broker-dealer balance sheets contracted sharply as leveraged positions were closed, and equity markets fell in tandem (Hattori & Shin, 2009). Japan was not a passive bystander to the crisis; its carry trade dynamics actively amplified it.

More recent patterns echo these concerns. The aggressive monetary easing of the post-2020 period widened the gap between U.S. and Japanese interest rates to historically large levels. Carry flows almost certainly moved into U.S. assets and emerging market bonds during this period, quietly accumulating leverage that would need to be unwound if and when the BoJ moved toward normalisation (Jiang et al., 2024).

4. Treasury Holdings and Dollar Ties

Japan holds over one trillion dollars in U.S. Treasury securities, placing it ahead of China and the United Kingdom as the largest foreign owner of American government debt (Statista, 2024). For the government and the central bank, these holdings serve as a reserve asset and a source of ammunition for currency intervention: selling Treasuries raises dollars that can be used to buy yen during sharp depreciations, providing a natural stabiliser for the exchange rate.

But the sovereign-level exposure is only part of the story. Japanese commercial banks, life insurers, and pension funds have also spent decades accumulating dollar-denominated assets, driven by the simple fact that domestic returns were too low to meet their investment targets. Unable to earn adequate returns on JGBs or domestic loans at near-zero rates, these

institutions borrowed in yen and invested in U.S. Treasuries, corporate bonds, and other dollar assets. The result is a structural foreign exchange mismatch sitting at the heart of the Japanese financial system: liabilities in yen, assets in dollars.

The consequences of this mismatch become acute the moment the BoJ considers raising rates. Three channels of damage open up simultaneously. First, higher Japanese rates would cause the yen to appreciate, which means the dollar-denominated assets on institutional balance sheets would be worth less in yen terms. For any institution that borrowed in yen to fund those investments, this is a direct foreign exchange loss that eats into capital. Second, if a yen spike triggers a global risk-off episode, U.S. Treasury yields could also rise as carry trades unwind, pushing down the mark-to-market value of the very bonds these institutions hold. Third, higher domestic funding costs would squeeze net interest margins for banks already sitting on low-yielding legacy loan portfolios. Each of these channels would be painful on its own; the prospect of all three occurring at once is what makes BoJ tightening feel genuinely dangerous.
Taken together, this institutional exposure means that raising rates is not simply a macroeconomic adjustment. It carries real risks to the solvency and stability of large parts of the Japanese financial sector, which in turn constrains what the BoJ feels able to do.

At the sovereign level, the bind is equally real. U.S. rate hikes reduce the market value of Japan's Treasury portfolio, inflicting mark-to-market losses at a time when public debt already exceeds 250% of GDP (Shiratsuka, 2025). Japan cannot sell its holdings quickly without disrupting U.S. bond markets and risking significant diplomatic and financial fallout. The dollar safety dynamic described by Jiang et al. (2024) captures this well: global demand for Treasuries locks holders into the cycle, with U.S. tightening hurting foreign balance sheets and dampening their appetite for rate hikes of their own.

5. The Trap Mechanism

The weak yen trap is best understood as a self-reinforcing loop with three interlocking components: persistently low domestic rates, carry trade dynamics, and the accumulation of dollar assets.

Low BoJ rates create the conditions for carry trades to flourish. Investors borrow in yen, sell that yen to buy foreign currency, and invest in higher-yielding assets abroad. This process weakens the yen, which boosts export competitiveness and keeps domestic inflation expectations anchored, giving the BoJ political cover to stay accommodative. As more carry traders pile in, the yen weakens further, making yen-denominated borrowing even cheaper in real terms and attracting yet more activity. Dollar assets accumulate on both institutional and sovereign balance sheets as the logical destination for this outbound capital flow (Fong, 2010; Hattori & Shin, 2009; Statista, 2024).

Tightening runs into obstacles on two fronts at once. Domestically, any move toward higher rates risks triggering sharp volatility in JGB yields and crystallising mark-to-market losses on the BoJ's enormous bond portfolio (Shiratsuka, 2025). For Japanese financial institutions with large dollar balance sheets, tightening opens the FX loss channels described in Section 4.

Internationally, a meaningful appreciation of the yen would force carry traders to unwind positions rapidly, with the kind of disorderly deleveraging that played out in 2007 as the worst-case scenario (Hattori & Shin, 2009). Any simultaneous rise in U.S. Treasury yields would compound the damage through the sovereign and institutional portfolio channels (Jiang et al., 2024).

What makes this a trap rather than just a difficult situation is the credibility problem at its core. Any signal from the BoJ that rates might rise accelerates carry unwinds before the hike even happens. Those unwinds threaten financial stability, giving the BoJ reason to pause or reverse course. The market then reads that hesitation as confirmation that rates will stay low, which invites more carry trade activity and deepens the dependence (McKinnon, 2012). The trap tightens with each cycle.

6. Global Stability Risks

The global stakes of a disorderly yen reversal are significant. A rapid carry unwind would put pressure on risk assets across the board, with emerging market bonds and equities likely taking the heaviest hits. Large-scale Treasury sales by Japan, whether forced by FX intervention needs or institutional balance sheet repair, would ripple through U.S. bond markets at a moment when the dollar's reserve currency status is already subject to debate (Jiang et al., 2024). The subprime crisis offered a preview of how far these dynamics can travel: yen carry positions penetrated deep into the broker-dealer funding chains that underpinned global credit markets, and their unwind accelerated the spread of stress (Hattori & Shin, 2009). Today's positions are larger and the financial system is more complex.

The domestic costs of staying in the trap, however, deserve equal attention. A persistently weak yen raises the yen-denominated price of energy and food imports, both of which Japan depends on heavily given its limited domestic resource base. This import-cost inflation acts as a stealth tax on households, particularly lower-income families that spend a larger proportion of their budgets on necessities. The gains from yen weakness flow disproportionately to large exporters and their shareholders, while ordinary consumers bear the costs. The distributional consequences are real and growing.

Prolonged low rates also distort how capital is allocated across the economy. Japanese banks, squeezed between near-zero lending rates and their need to generate returns for depositors, have been pushed steadily toward riskier and more complex foreign investments. This perpetuates the very dollar exposure problem identified in Section 4 and crowds out domestic investment in productive capacity. Japan's sluggish productivity growth over the past two decades is partly a story about capital being misallocated by a financial system trapped in a low-rate environment.

The fiscal dimension is perhaps the most sobering. Japan's debt already exceeds 250% of GDP, and even a modest sustained rise in JGB yields would significantly increase the government's debt servicing burden as bonds mature and are refinanced at higher rates. The BoJ's own balance sheet adds another layer of fragility: with the central bank holding the majority of outstanding JGBs, rate normalisation would generate losses that could ultimately require recapitalisation from the Treasury, adding

to the very debt pile that makes normalisation so difficult in the first place. It is a feedback loop between monetary policy and public finances that erodes the BoJ's practical independence over time.

Japan's predicament, then, is not simply a monetary policy puzzle. It is a window into the structural tensions of the dollar-centric global financial system, where the demand for safe assets binds creditor nations in ways that are quietly corrosive of their policy autonomy (Jiang et al., 2024; McKinnon, 2012).

Conclusion

Japan's weak yen trap is the product of decades of policy choices that have compounded into a situation where almost every exit route carries serious risks. Yield curve control kept borrowing costs suppressed across the entire maturity spectrum, not just at short maturities, by having the BoJ commit to unlimited JGB purchases to hold 10-year yields near zero. This turbo-charged the interest rate differentials that make yen carry trades profitable, while the BoJ's ballooning balance sheet made the eventual exit from the policy fraught (Shiratsuka, 2025; Fong, 2010). Investors took full advantage, building leveraged positions worldwide on the back of cheap yen funding and creating a stock of carry trades that could unwind badly if the yen were to rise sharply (McKinnon, 2012; Hattori & Shin, 2009).

Meanwhile, Japan's over one trillion dollars in U.S. Treasury holdings locked it into a different kind of dependency, one shaped by U.S. monetary cycles rather than domestic conditions (Statista, 2024; Jiang et al., 2024). What makes this exposure particularly constraining is that it extends well beyond the government's balance sheet. Japanese banks, insurers, and pension funds borrowed in yen for years to invest in dollar assets, creating a structural FX mismatch that turns any BoJ rate hike into a potential balance sheet crisis for large parts of the domestic financial sector. This institutional dimension is easy to overlook but it is central to understanding why the BoJ has moved so cautiously. The trap persists because staying loose avoids immediate pain across all these channels, even as it deepens yen weakness, squeezes household purchasing power, distorts capital allocation, and continues to build vulnerabilities that would have to be absorbed eventually.

Japan's situation also illuminates something important about the dollar-centric global financial system. When a country accumulates Treasuries on the scale Japan has, it is not simply holding a reserve asset; it is accepting a degree of monetary subordination to the U.S. financial cycle. Carry trades amplify this dynamic, turning what is nominally a domestic monetary policy decision into a variable with global consequences (Jiang et al., 2024; McKinnon, 2012). The subprime crisis made this visible in the most dramatic way possible (Hattori & Shin, 2009).

A gradual and well-signalled BoJ normalisation, combined with macroprudential measures to limit the build-up of unhedged institutional FX exposure, would be the most defensible path out. Broader international coordination on interest rate differentials could help blunt the carry trade dynamics that make unilateral action so costly (McKinnon, 2012). Neither is straightforward in

References

- McKinnon, Ronald. 2012. "Carry Trades, Interest Differentials, and International Monetary Reform." Journal of Policy Modelling (NEW YORK) 34 (4): 549–67. https://doi.org/10.1016/j.jpolmod.2012.05.010.

- Sigogne, Philippe, Jacky Fayolle, Hélène Baudchon, Odile Chagny, Amel Falah, Olivier Passet, Christine Rifflart, et al. 1997. "Un compromis monétaire favorable à l'Europe." Observations et diagnostics économiques 61 (1): 5–92. https://doi.org/10.3406/ofce.1997.1453.

- Fong, Wai Mun. 2010. "A Stochastic Dominance Analysis of Yen Carry Trades." Journal of Banking & Finance (AMSTERDAM) 34 (6): 1237–46. https://doi.org/10.1016/j.jbankfin.2009.11.017.

- Shiratsuka, Shigenori. 2025. "What Did the Bank of Japan Do under the Yield Curve Control Policy?" Journal of the Japanese and International Economies 76: 101352. https://doi.org/10.1016/j.jjie.2025.101352.

- Jiang, Zhengyang, Arvind Krishnamurthy, and Hanno Lustig. 2024. "Dollar Safety and the Global Financial Cycle." The Review of Economic Studies (UK) 91 (5): 2878–915. https://doi.org/10.1093/restud/rdad108.

- Hattori, Masazumi, and Hyun Song Shin. 2009. "Yen Carry Trade and the Subprime Crisis." IMF Staff Papers (London) 56 (2): 384–409. https://doi.org/10.1057/imfsp.2009.2.

- Statista. (2024). Largest foreign holders of U.S. Treasury bonds as of [December 2023], by country (in billion U.S. dollars). Retrieved [17th February 2026], from https://www.statista.com/chart/31941/largest-foreign-holders-of-us-treasury-bonds/

- Statista. (2026). U.S. dollar (USD) to Japanese yen (JPY) exchange rate from June 2021 to February 2026. Retrieved February 17, 2026, from https://www.statista.com/statistics/960314/quarterly-exchange-rate-usd-to-jpy/

EPIS Network

Recent Delegations



Last month, our Fellow Florian Muanda represented EPIS at the 13th Africa–Europe Science Collaboration Forum in Brussels

Upcomming Delegations



- 4 May: NEXT Milan Forum, **Milan**, IT
- 12-13 May: Defence & Aerospace Industry Meeting & Exposition, **Vilnius**, LT
- 18-21 May: ESP Europe Conference, **Prague**, CZ
- 01 Jun: Black Sea Security Forum, **Odesa**, UA
- 15-19 Jun: Eurosatory 2026, **Paris**, FR
- 27 Jun: Belgian Airforce Day, **Florennes**, BE
- 06-10 Jul: World Venture Forum, **Kitzbuhel**, CH
- 18-24 Jul: YATA - 30 Years Reflecting Transatlantic Security, **Lisbon**, PO

Recent Accomplishments

Our EPIS WhatsApp Chatbot went live lately. This not only brings you more convenience in talking to us, but you can also ask it questions on EPIS. Give it a try!
>> EPIS Chatbot

EPIS Conference

This month, we organise an EPIS Policy Competition on EU enlargement. Submit your proposal now!
>> EPIS Policy Conference

EPIS Network Conference

Job Openings

- **Intern, EPIS Think Tank**
  - Get insights into the workings of Europe's largest student think tank
  - Support us with organisational and research tasks
  - Applications received on a rolling basis
  - apply on our **>> Website**
- **Intern, Mekong Institute**
  - Support regional cooperation among the Mekong countries
  - Apply on the **>> Website**

Chapter Updates



- Our Belgium Chapter met up in Brussels to grab dinner and discuss EU affairs
- Our UK Chapter is organising a meetup that will likely take place in London this month

Join Us

Not yet an EPIS Fellow but you read our newsletter?

>> Join EPIS Now!

APPLY



Message Sonja on WhatsApp. She will assist you :)

EPIS Delegations Leader
+49 155 6597 5423
delegations[at]epis-thinktank.com

Still got Questions ?



About the Article

Can CIPS, SPFS, and mBridge realistically replace SWIFT as the backbone of global financial messaging and settlement? Each alternative serves a distinct purpose: RMB internationalisation, sanctions resilience, or CBDC-based settlement, but none replicates SWIFT's scale, and most still depend on it. The payment infrastructure is evolving toward multipolarity, not replacement — parallel systems are emerging, but SWIFT remains the global standard for now.

About the Author

Cyprian Krystek is a graduate of the University of Gdańsk, Poland with an MSc in Investments and Real Estate Management. His master's thesis focused on adapting public investments to climate change using Cost–Benefit Analysis. He works as a Public Investment Consultant with experience supporting World Bank and EU projects, including EU funds acquisition and capacity-building in Public Investment Management in North Macedonia and Moldova.

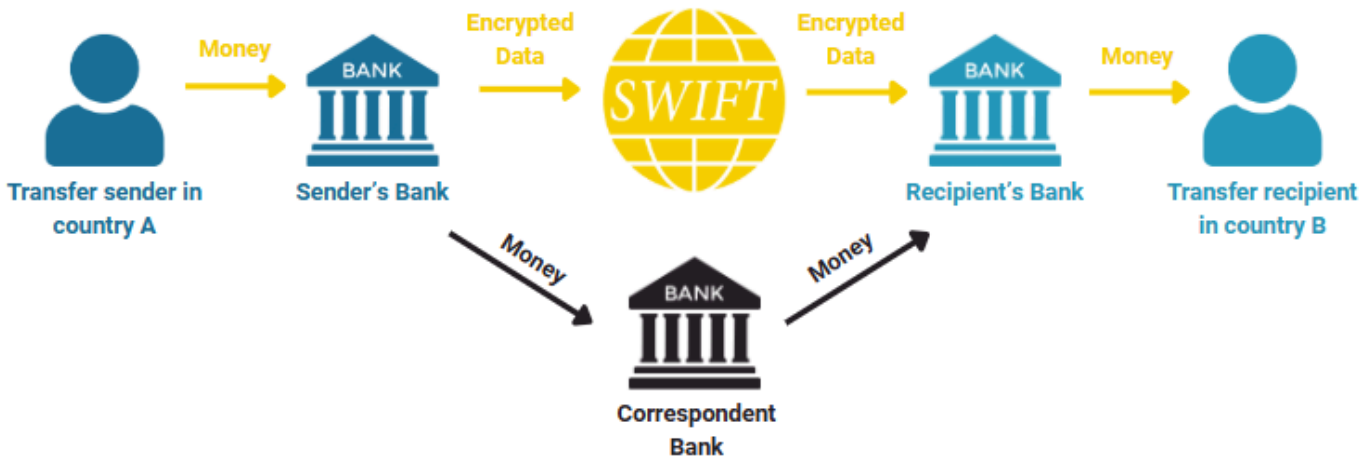
1. Introduction: why global payment systems matter

Payment and financial messaging systems constitute critical financial market infrastructure because they operationalise trade, investment, and remittance flows by enabling the clearing/settlement of claims and the secure transmission of transaction instructions and data. The World Bank explicitly links secure, affordable, and accessible payment and settlement systems to development outcomes, financial stability, and financial inclusion (World Bank Group, 2026). Policy initiatives under the Financial Stability Board's G20 Roadmap identify persistent frictions in cross-border payments: speed, cost, transparency, and access. It highlights that infrastructure and interoperability are policy variables, not merely operational choices (Financial Stability Board, 2025). Since 2022, the increasing salience of sanctions and broader geoeconomic fragmentation has drawn attention to the jurisdictional concentration of key networks and to the strategic value of connectivity itself.

2. What is SWIFT and how does it work

Society for Worldwide Interbank Financial Telecommunication (SWIFT) was founded in 1973 as a network for transmitting information. It is defined as a secure financial messaging network, rather than a payment, clearing, or settlement system. SWIFT is used to transmit authenticated, standardised instructions and related data between financial institutions. The movement of funds occurs through banks' accounts, correspondent banking arrangements, and underlying settlement mechanisms (Swift, 2025). Its systemic role is primarily associated with (Cerutti et al.): standardisation (common message types and codes, ISO20022), scale and network effects as well as operational trust rooted in security, high availability, and institutionalised oversight.

Because access is legally contingent, SWIFT connectivity has become a channel of geopolitical leverage. In March of 2022, EU restrictive measures prohibited the provision of specialised financial messaging services to designated Russian entities, and SWIFT publicly



Sources: 1st graphic - own work based on SWIFT website

confirmed disconnections in compliance with EU regulations (Council of the EU, 2022). A further example is SWIFT's 2018 suspension of access for certain Iranian banks due to Iran withdrawing from JCPOA, reported as a "regrettable" step taken in the interest of system stability (Reuters, 2018). Against this backdrop, attention has increasingly turned to non-SWIFT channels and projects including China's CIPS, initiatives led by the Bank of Russia, and multi-CBDC experiments such as mBridge whose functions and substitutability require separate, disaggregated analysis.

3. China's CIPS: payments, currency strategy, and CNY Internationalisation

SWIFT: a cooperative financial messaging network founded in 1973, connecting 11,500+ institutions across 200 countries — it transmits payment instructions but does not itself move or settle funds.

Cross-Border Interbank Payment System (CIPS) is structurally closer to an end-to-end payment infrastructure than SWIFT, because it is presented as a wholesale payment system authorised by the People's Bank of China (PBOC) and specialised in cross-border Renminbi (RMB) clearing and settlement (not merely message transmission). In its institutional self-description, CIPS frames its mandate in operational terms: reliability, efficiency, convenience, and low cost, explicitly tied to RMB cross-border payment clearing and settlement services (CIPS, n.d.). Governance is hybrid, policy authority rests with the PBOC (authorisation and rule-setting), while operations are performed by a dedicated operator. CIPS (as the operating institution) states it takes "full charge" of operation, maintenance and development of the system, services to participants, implementation of standards, and market expansion and provides RMB cross-border clearing and settlement and related services to authorised domestic and foreign institutions. That governance model implies a state anchored infrastructure with corporate style operational capacity, rather than a private cooperative like SWIFT (CIPS, n.d.).

The public data on volumes indicates rapid scaling in RMB corridors. A PBOC published statistical note on payment system operations reports that in 2024 "the RMB cross-border payment system" processed over 8 million transactions with value RMB 175 trillion, up 24% and 43% respectively on a year to year basis. It also reports daily averages of 30 thousand transactions and RMB 652 billion. Participant numbers show expanding international connectivity, but the architecture remains tiered. CIPS' participants announcement states that as of December 2025, there were 193 direct participants and 1,573 indirect participants. As of indirect participants, 1,154 were from Asia (including 565 from Mainland China), 261 from Europe, 67 from Africa, 35 from North America, 32 from South America and 24 from Oceania, with participants located in 124 countries and regions worldwide (CIPS 2025)

Interoperability with SWIFT has been a design feature rather than a transitional accident. SWIFT's 2016 press release on the SWIFT–CIPS memorandum of understanding states that the

collaboration would develop CIPS "using SWIFT as the secure, efficient and reliable channel" to connect CIPS with SWIFT's global user community. This reduces switching costs for banks already embedded in SWIFT and preserves the possibility that CIPS growth can be additive to (not necessarily competitive with) SWIFT connectivity (SWIFT, 2016). IMF analysis reinforces the point that CIPS is not yet a clean "bypass." In its Staff Discussion Note on geoeconomic fragmentation, the IMF describes CIPS as providing clearing and settlement of RMB cross-border transactions and offering a messaging standard, but states that CIPS still relies on the SWIFT messaging system "to a large extent" to carry out a sizeable portion of its payments. The IMF framing is significant: it treats technical capability and geopolitical intent as distinct from realised autonomy, and points to continuing dependency on established messaging infrastructure for global reach (IMF, 2023).

Geoeconomic fragmentation: the process by which political tensions translate into parallel financial infrastructures, embedding geopolitics directly into the cost of cross-border transactions.

The currency strategy dimension is therefore best read as capacity building for RMB use, not a demonstrated shift in global currency hierarchy. SWIFT's own RMB Tracker reports that in January 2026 the RMB was the 5th most active currency for global payments by value, with a 3.13% share. This is non-trivial for selected trade corridors, but it remains far below the levels implied by a world "moving beyond" dollar-centric settlement in aggregate. CIPS can reduce frictions in RMB settlement where trade already supports RMB usage, but it cannot on its own create global RMB liquidity and asset-market depth (SWIFT, 2026).

4. Russia's SPFS: sanctions and financial sovereignty

The System for Transfer of Financial Messages (SPFS) is explicitly a messaging channel, not a settlement system. The Bank of Russia presents it as a 24/7 "safe and reliable channel" for exchanging electronic messages on financial transactions. Efficient use of the system requires that participating institutions have established mutual correspondent relations (settlement still relies on correspondent banking and underlying payment arrangements). This design choice is consistent with a resilience objective: preserving the ability to exchange instructions even under constraints on access to external messaging providers (Bank of Russia, 2025). Governance and technical interoperability are tightly controlled by the Bank of Russia. SPFS clients can send and monitor financial messages in SWIFT formats, use proprietary formats, exchange ISO 20022 messages, and manage counterparty/message-type lists. Foreign users can connect directly or via a Service Bureau, with a stated per-message fee for direct participants of RUB 0.8–1.0 (reported as < USD 0.02). This is important institutionally:Russia has pursued "format compatibility" to lower adoption barriers for banks already operationally configured around SWIFT and ISO 20022 semantics, even if the network is not globally accepted.

Measured scale remains limited relative to SWIFT, but the system has expanded under sanctions pressure. In its Annual Report for 2024, the Bank of Russia states that SPFS served as the main financial messaging channel for domestic settlements using correspondent accounts and provided functionality for foreign participants. It reports 584 institutional SPFS users at the end of 2024 and notes that total messages increased by 23% relative to 2023 traffic (Bank of Russia, 2024). The economic function of SPFS becomes clearer when read against the operational shock of SWIFT restrictions. The Bank of Russia's Annual Report for 2022 asserts that disconnection from SWIFT did not disrupt financial transactions and had "almost no effect" on clients' domestic settlements owing to Russia's domestic card system and the Financial Messaging System. It explicitly states a priority to develop settlement infrastructure with foreign partners that is independent of sanctions. This is a direct articulation of "financial sovereignty" as continuity of domestic payments and selective external settlement channels, rather than an attempt to replicate SWIFT's global utility. However, all these statements must be taken with a grain of salt, given Russia's tendency to spread disinformation.

Interoperability with SWIFT is therefore best characterised as syntactic/format compatibility rather than network substitutability. SPFS' ability to exchange SWIFT-format messages and ISO 20022 messages reduces banks' internal integration costs, but it does not remove the constraint that cross-border settlement ultimately depends on correspondent accounts, currency convertibility, and access to clearing in major currencies—areas where sanctions and de-risking dynamics apply directly.

After 2024, the EU moved from SWIFT restrictions to constraining Russia's alternative messaging stack. Council Regulation (EU) 2024/1745 introduces Article 5ac, prohibiting (from 25 June 2024) EU legal persons operating outside Russia from directly connecting to SPFS (or equivalent specialised messaging services set up by the Central Bank of Russia). This regulation establishes a transaction ban with entities that use SPFS outside Russia to increase Russia's financial resilience or support sanctions circumvention. It also details targeted exemptions (eg, certain energy, food, humanitarian, and legacy contract cases). The explicit aim in the regulation's recitals is to contain SPFS development and prevent frustration of EU measures (European Council, 2024).

5. The mBridge Project: a multi-CBDC platform

mBridge differs categorically from CIPS and SPFS: it is conceived as a shared settlement platform (not a messaging overlay) that can execute cross-border payments directly in central bank money on a distributed ledger, potentially compressing the correspondent banking chain. Bank for International Settlements (BIS) describes the mBridge platform as a multi Central Bank Digital Currency (CBDC) arrangement built on distributed ledger technology to enable instant cross-border payments and settlement. It also emphasises the goal of addressing high costs, low speed and operational complexity in cross-border payments, and the retreat of correspondent banking in some jurisdictions (Bank for International Settlements, 2024).

Governance has been multi-institutional from inception. Bank for International Settlements

reports mBridge as the product of collaboration starting in 2021 between the BIS Innovation Hub, the Bank of Thailand, the Central Bank of the UAE, the Digital Currency Institute of the People's Bank of China, and the Hong Kong Monetary Authority, with the Saudi Central Bank joining as a full participant in 2024. The BIS project page also lists numerous observing institutions (including the ECB and IMF among others), indicating broad official-sector interest even where participation remains observational.
The 2022 pilot of mBridge Project provides concrete "real-value" evidence relative to most CBDC discourse. The BIS authored report "Project mBridge: Connecting economies through CBDC" states that between 15 August and 23 September 2022, 20 commercial banks from Hong Kong SAR, Mainland China, the UAE and Thailand conducted cross-border payment on behalf of corporate clients using CBDCs issued by their respective central banks. It reports that about US$12.1 million of CBDC liquidity was issued on-platform, facilitating 164 cross-border payments totalling about US$22.1 million. The pilot also quantified currency-by-currency issuance and transaction values, underscoring that mBridge tested real monetary constraints rather than artificial balances (Bank for International Settlements, 2022).

In terms of SWIFT interoperability, mBridge is not designed as a SWIFT-compatible messaging rail. It is a settlement platform that would have to integrate with banks' existing compliance, messaging, and operational systems. The BIS report explicitly states that extending access to central bank money directly to foreign participants and conducting transactions on a shared ledger raise policy, data privacy, governance, and legal questions that may require regulatory changes for full legal certainty. The implication is that mBridge could bypass segments of correspondent banking for participating corridors, but only within a tightly governed and legally enabled club of jurisdictions.

6. Comparative analysis: do these systems challenge SWIFT?

A functional comparison requires separating:

- messaging scale,
- settlement capability,
- political/legal accessibility.

On messaging scale, SWIFT remains systemically dominant: it reports 13.4 billion financial messages in 2024 (average 53.3 million/day), 11,500+ institutions connected, and 224 countries and territories. On settlement, SWIFT does not settle funds, whereas CIPS is presented as a wholesale clearing and settlement system for RMB cross-border payments, and mBridge is a prototype settlement platform using CBDCs. SPFS sits closer to SWIFT in that it is a messaging channel, but it is nationally anchored and requires correspondent relations for settlement.

Governance and legal positioning differ in ways that materially affect adoption. SWIFT is a cooperative subject to central bank oversight since 1998, and its oversight framework is being anchored in Belgian law and enforced by the National Bank of Belgium from 2026. CIPS is authorised by the People's Bank of China and operated by CIPS Co., Ltd. under PBOC approved activities. SPFS is operated by the Bank of Russia and is now explicitly targeted by EU and US sanctions instruments. mBridge governance is being developed as a bespoke

multinational framework associated with participating central banks and monetary authorities.

Adoption metrics reinforce the asymmetry. CIPS reports 193 direct participants and 1,573 indirect participants as of December 2025, while SPFS reports 584 institutional users at end of 2024 and had 462 users in 2022, mBridge's 2022 pilot involved 20 commercial banks and four jurisdictions with real value settlement, and the Minimum Viable Product phase broadens participation but remains conditioned by jurisdictional readiness. These numbers describe different network logics: SWIFT is global, CIPS is currency-specific with tiered access, SPFS is sovereignty oriented with constrained internationalisation, mBridge's is corridor based and institutionally clublike.

7. Implications for International Economic Relations

The first consequence is a shift in the economics of sanctions. When SWIFT was regarded as the main communications hub, exclusion from SWIFT increased settlement costs and created operational friction (even if it did not block all flows). As alternatives develop, pressure is mounting for sanctions to also cover substitute infrastructure. In 2024, the EU introduced restrictions on SPFS, whilst in 2024 the US, through The Office of Foreign Assets Control (OFAC), formally raised the sanction risk for joining SPFS and warned against exposure to institutions using this channel. This marks a shift from participant based sanctions towards ecosystem based sanctions, which has long term implications: it increases the incentive for countries at risk of restrictions to invest in infrastructure and local settlement currencies (Bank Slovenije, 2025).

	Swift	CIPS	SPFS	mBridge
Primary Function	Financial messaging network	RMB clearing + settlement system	Financial messaging network + settlement	Multi-CBDC platform combining payment + settlement
Governance	Cooperative; central bank oversight since 1998; Belgian-law framework from 2026	Authorised by PBOC; operated by CIPS Co., Ltd.	Operated by Bank of Russia	Bank for International Settlements + participating central banks
Number of participants	11 500+	193 direct + 1 573 indirect	584	20
Daily cashflows	~34 trillion €	~86 billion €	not specified	~23 million € (only for the pilot period)

Sources: 2nd graphic - own work based on SWIFT, CIPS, SPFS and mBridge official documentation

The second implication concerns the cost of trade and investment. Payment infrastructure is, in the literal sense, a layer of transaction costs in trade. In a working paper from March 2026, the European Central Bank estimated that countries with directly interconnected payment systems exhibit approximately 4% higher trade volumes. This effect is economically significant and increases when the links involve systems capable of wholesale transactions and when they connect smaller economies with weaker correspondent banking networks. This finding is particularly important for the assessment of mBridge and other settlement solutions. Even if geopolitical motives are strong, the economic benefits of reducing friction in payments can be real and measurable (European Central Bank, 2026).

The third consequence is the risk of financial network fragmentation. In its analyses of geofragmentation, the International Monetary Fund highlights the multilayered nature of cross-border payments and the dominant role of SWIFT as a communication standard. The IMF also notes that alternatives are emerging and that interoperability dependencies with SWIFT still exist. In its paper on global cross-border payments (2021–2024), the IMF notes that payment networks have, on average, evolved towards greater connectivity and less concentration. However, increasing geopolitical fragmentation is linked to a decline in the value of cross-border payments, particularly in the large value payments segment between financial institutions. In the language of international economics, this means that payment infrastructure can become a channel for transmitting political shocks to financing costs and trade, even without a formal change in tariffs or regulatory barriers to trade in goods (International Monetary Fund, 2023).

The fourth consequence manifests itself at the corporate and banking levels. Decisions to join alternative systems are becoming decisions regarding geopolitical exposure. A major international bank joining CIPS as a direct participant can be interpreted as a business move, increasing its capacity to serve clients in RMB, but also as infrastructural insurance in the event of further fragmentation. On the other hand, joining the SPFS carries a growing risk of sanctions, as explicitly signalled by OFAC in 2024, whilst the EU has imposed restrictions through regulations concerning EU institutions and transactions with third country banks using the SPFS. As a result, these alternatives don't remove politics from cross-border payments. They just embed it differently, making it a factor that directly affects how expensive it is to borrow money and complete transactions (Financial Times, 2024).

8. Conclusion: evolution, not replacement?

In the short to medium term, the world is not moving beyond SWIFT in the sense of completely replacing the global communications network. The scale and network effect of SWIFT, over 11,500 institutions across 200 countries and territories, and daily traffic volumes in the tens of millions of messages, remain qualitatively different from those of the alternatives. CIPS is a growing RMB settlement infrastructure with volumes in the hundreds of trillions of RMB annually, but in practice it still engages in interoperability with SWIFT and is limited in terms of currency coverage. SPFS ensures Russia's financial communication continuity in domestic

settlements and limited connectivity with selected foreign entities, but is subject to growing sanctions pressure and lacks global acceptance. mBridge points the way to the competition of the future - the integration of communication and settlement on a shared ledger, but is at the pilot stage, with a limited scale of actual transactions compared to the global cross-border payments market.

A more accurate statement would therefore be that the payments infrastructure is evolving towards greater multipolarity and political sensitivity. Alternatives to SWIFT, varying in their motivations (currency strategy, resilience to sanctions, reduction of cost and time frictions) are reshaping the landscape of risks and costs in trade and finance. However, the centre of gravity of competition may be shifting from the messaging layer itself to the layer of digital settlement and platform interoperability (CBDCs, direct system links), which, if they achieve the scale and capacity for final settlement across multiple jurisdictions, could pose a real challenge to the current architecture. For now, these represent parallel pathways and safeguards rather than a fully fledged alternative to the global standard for financial communication.

References

- Financial Infrastructure | World Bank Group. (2026). Worldbank.org. https://www.worldbank.org/en/topic/paymentsystemsremittances?utm
- G20 Roadmap for Enhancing Cross-border Payments. (n.d.). https://www.fsb.org/uploads/P091025-1.pdf
- Swift description. (2025, September 25). Swift to set new rules for retail cross-border payments on its network in bold move to further ramp up speed and predictability | Swift. https://www.swift.com/news-events/press-releases/swift-set-new-rules-retail-cross-border-payments-its-network-bold-move-further-ramp-speed-and-predictability?
- Global Cross-Border Payments: A $1 Quadrillion Evolving Market?, IMF Working Papers
- https://www.elibrary.imf.org/view/journals/001/2025/120/001.2025.issue-120-en.xml?cid=lk-com-dsp-imf.org
- Swift, Annual review 2024 https://www.swift.com/about-us/swift-annual-review
- Russia's military aggression against Ukraine: EU bans certain Russian banks from SWIFT system and introduces further restrictions. (2022). Consilium. https://www.consilium.europa.eu/en/press/press-releases/2022/03/02/russia-s-military-aggression-against-ukraine-eu-bans-certain-russian-banks-from-swift-system-and-introduces-further-restrictions/?utm_
- Reuters Staff. (2018, November 5). SWIFT says suspending some Iranian banks' access to messaging system Reuters. https://www.reuters.com/article/business/swift-says-suspending-some-iranian-banks-access-to-messaging-system-idUSKCN1NA1PN/
- CIPS Participants Announcement No. 116 (2025) https://www.cips.com.cn/en/2026-01/16/article_20260116134230413 85.html?utm
- Swift offers secure financial messaging services to CIPS, SWIFT 2016. https://www.swift.com/news-events/press-releases/swift-offers-secure-financial-messaging-services-cips?utm_

- E. Cerutti, M. Firat, M. Hengge, Global Cross-Border Payments: A $1 Quadrillion Evolving Market?, IMF Working Paper WP/25/120, International Monetary Fund, 2025
- Cross-Border Interbank Payment System. https://www.cips.com.cn/en/about_us/about_cips/introduction/index.html
- Geo-Economic Fragmentation and the Future of Multilateralism; Staff Discussion Note No: 2023/001; January 15, 2023 https://www.imf.org/-/media/files/publications/sdn/2023/english/sdnea2023001.pdf
- Project mBridge reached minimum viable product stage https://www.bis.org/about/bisih/topics/cbdc/mcbdc_bridge.htm
- Project mBridge, Connecting economies through CBDC, October 2022, BIS Innovation Hub https://centralbank.ae/media/lnchuury/project-mbridge-connecting-economies-through-cbdc-final.pdf
- Restrictive measures against Russia, Bank Slovenije, 2025 https://www.bsi.si/en/banking-supervision/financial-restrictive-measures/restrictive-measures-against-russia
- Interlinking payment systems and trade flows, Working Paper Series No 3202, European Central Bank, 2026 https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp3202~028f70f8ec.en.pdf
- Geoeconomic Fragmentation and the Future of Multilateralism, International Monetary Fund, 2023 https://www.imf.org/-/media/files/publications/sdn/2023/english/sdnea2023001.pdf
- HSBC Hong Kong joins China's alternative to Swift global payments system, Financial Times, 2024 https://www.ft.com/content/2c96f54c-f831-495b-85ca-4defaf5432f0
- COUNCIL REGULATION (EU) 2024/1745 of June 2024 amending Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine https://www.balticshuttle.ee/custom/files/eu_council_regulation_2024_1745.pdf
- RMB Tracker Monthly reporting and statistics on renminbi (RMB) progress towards becoming an international currency, 2026 https://www.swift.com/sites/default/files/files/rmb-tracker_february-2026.pdf
- Financial Messaging System of the Bank of Russia (SPFS), Bank Of Russia 2025 https://www.cbr.ru/eng/development/mcirabis/fin_msg_transfer_system/
- Annual Report, Bank of Russia 202 https://www.cbr.ru/Collection/Collection/File/55580/ar_2024_e.pdf



About the Article

To what extent does international law constrain the EU's use of Russian central bank reserves? This article argues that sovereign immunity and the limits of countermeasures not only restrict the EU's action but directly shape its sanctions design. It concludes that outright seizure of assets would likely be unlawful, and that any financial sanctions must be designed around the limits of international law.

About the Author

Maximilian's research focus lies in the area of European defence integration and EU trade policy. With a background in European and international law, his research aims to better understand the internal and external implications of the EU's open strategic autonomy agenda through the lens of the European defence market and the EU's response to geo-economic competition

1. Introduction

When European leaders met at the European Council in December 2025, one topic was high on the agenda: how frozen Russian assets could be used to finance Ukraine without formally transferring ownership or violating international law. These assets, which are held primarily by the Belgian financial services provider "Euroclear," have been frozen since 2022.

This debate around Russian assets does not arise in isolation. It is part of an unprecedented sanctions regime that the EU adopted against Russia. These sanctions included asset freezes, trade restrictions, and airspace closures. Particularly impactful were measures targeting financial infrastructure, including the exclusion of Russian banks from SWIFT and the withdrawal of services by major payment providers. Similarly, key service providers such as Visa and Mastercard retreated from the Russian market.

Countermeasures refer to non-forcible measures taken by a State in response to an interna-tional wrongful act of another State, aimed at achieving cessation or reparation.

Among these measures, the freezing of Russian central bank reserves stands out. These sanctions are directed against assets that constitute an essential element of a State's monetary sovereignty, enabling the State to stabilise its currency and perform international transactions. Given its core functions for the State, these assets are, to some extent, protected under international law. While these legal questions were already raised when freezing Russian central bank reserves, these issues became much more prominent in recent discussions on how these assets could be used without formally transferring ownership. It was, in fact, these legal concerns, rather than practical limitations, that led to the creation and abandonment of the Commission's Reparation Loan scheme. This paper argues that the European Union's (EU) ability to act on the Russian central bank reserves is severely restricted by international law and that these constraints explain both the design and the limits of the EU's approach. In particular, it shows that the EU's approach is characterised by attempts to preserve the formal legal status of the assets while nevertheless extracting economic value from them.

To showcase the critical impact that these legal considerations had on the policy choices of the European Council, it is appropriate to provide a clearer picture of the legal challenges that the EU faced. This is not only helpful to explain the December 2025 Council decisions but also serves as an illustration of the legal limits of EU action in the future.

In essence, the legal controversy can be traced back to a clash of two legal ideas: On one hand, under the law of sovereign immunity, central bank assets are protected from interference of third countries. On the other hand, the law of State responsibility allows countermeasures in response to another State's breach of

international law, such as, for example, Russia's invasion of Ukraine. This paper aims to provide some insights into this controversy in order to determine its implications for the EU's past and future action.

This paper will be divided into two parts. Part I will focus on the framework that governs central bank reserves under international law by first analysing the types of protection afforded to central bank reserves and secondly examining whether an unlawful interference with these protections could be justified as countermeasures. Part II will then apply these concepts to the case of the EU's handling of frozen Russian central bank reserves. It will analyse how the EU structured its response to avoid the legal risks associated with outright seizure and why it nevertheless abandoned its Reparation Loan scheme.

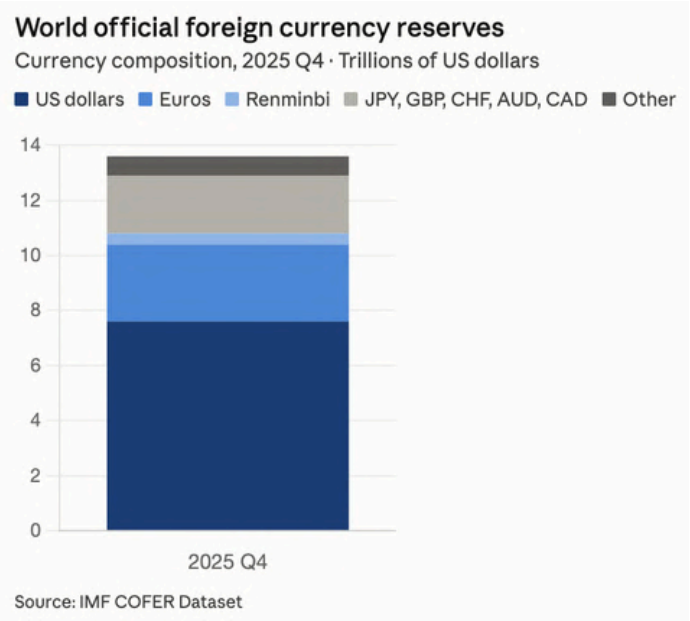


Figure 1 - Source: COFER Dataset

2. Central Bank Reserves: The Law

When it comes to the seizure of Central Bank Reserves (CBR), most political discussions are underpinned by legal considerations. The legal discussions on the seizure of CBR can be reduced to two key concepts in international law: immunity and countermeasures. These legal concepts are not merely theoretical but determine which forms of action are realistically available to the EU in practice. This chapter will analyse the two concepts in the abstract, and the next chapter will analyse the EU's conundrum in detail.

2.1 Sovereign Immunity: Are Russian CBR Protected?

In this context, sovereign immunity, in simple terms, means that one State is restricted in what action it can undertake regarding the property or persons of another State located in its territory. Conceptually speaking, there are two strands of immunity. Personal immunity refers to the immunity enjoyed, for example, by heads of State or other foreign officials. Material immunity protects State property located in another State. This covers, for example, CBRs, which are, to some extent, protected against seizure under the material aspect of the law of sovereign immunity. This is a simplified, conceptual description of sovereign immunity, and the precise content of this norm under international law will be discussed in greater depth below.

Material sovereign immunity is based on several sources of international law. First, several regional treaties and the UN Convention on Jurisdictional Immunities of States and their Property address the question of immunities. However, the limited membership of the former and the fact that the latter convention has not yet entered into force render this source of law less relevant for most cases. Secondly, most aspects of the UN Convention are considered to reflect

customary international law. Customary international law is a source of international law that is binding for all States and, put simply, is created through continuous State practice under the belief that a legal obligation exists to behave that way. These customary norms form the legal background to most discussions of central bank immunities.

Because customary international law is created by State behaviour and is not codified in treaties, it is often difficult to establish the exact content of obligations under customary international law. When trying to identify what exactly States are allowed and not allowed to do under the law of sovereign immunity, one must look at two concrete aspects: (1) what assets are protected, and (2) against which acts these assets are protected.

First, regarding which acts and assets are covered by sovereign immunity, one must distinguish between two approaches. Following the absolute immunity approach, all activities of the sovereign are covered by immunity. Under this approach, all Russian State assets located abroad would be protected, even if they are used in purely commercial transactions. This actor-focused approach has largely been rejected under international law. Instead, a more restrictive, functional approach is adopted, which considers the nature of the activity in question. Here, it distinguishes between acta iure imperii, referring to acts of a State in its sovereign capacity, and acta iure gestionis, referring to acts of a State of a commercial nature. The former are subject to sovereign immunity, whereas the latter are not. The UN Convention follows that approach, and most scholars and States agree that the functional approach is reflective of customary international law. Translated into practical effects, this more restricted approach means that where Russian assets are merely used for commercial transactions, for example, to contract workers for repainting the Russian embassy in Berlin, these transactions and assets would not be covered by sovereign immunity. However, CBR assets are directly linked to the exercise of sovereign capacity, namely, to influence and direct the Russian State's monetary policy. These assets would be protected by sovereign immunity.

The EU's approach must be understood not as an attempt to seize these assets, but as an effort to achieve similar economic effects while remaining within these legal limits.

Secondly, a question arises regarding the acts against which these acts and assets are protected. The UN Convention and most scholars refer to "jurisdictional" immunities, meaning that the assets are protected from the other State's adjudicatory and enforcement jurisdiction. The latter protects, for example, against so-called attachment or execution procedures whereby assets of the foreign State are "blocked" or seized to ensure the availability of compensation in the process of court proceedings against the foreign State. Some commentators have pointed out that, in the absence of a link to court proceedings, the seizure or freezing of CBRs would not trigger the rules of State immunity. This approach is supported by the Convention, the International Law Commission's Draft Articles, and, to some

extent, State practice. Thus, a determining factor is whether the acts of the home State against property of the foreign State took place within the context of judicial proceedings. The internal law of the home State determines this question. However, it is important to note that some States and scholars are critical of this approach. In Timor-Leste v Australia, the applicant State argued that adopting such a narrow understanding of immunity would allow States to disregard their obligations under the law of immunity simply by issuing executive rather than judicial orders, creating a paradoxical and undesirable situation.

Applying these norms to the case of CBRs, it is clear that under a restrictive approach to immunity, central banks are acting in sovereign capacity of the State, meaning their acts are acta iure imperii and thus protected by sovereign immunity. If a broader understanding of immunity is followed, under which executive, administrative, and legislative acts are covered, seizure of CBRs would implicate sovereign immunity. However, if one follows the approach of the UN Convention and the International Law Commission, the question of whether CBRs are protected against seizure under sovereign immunity depends entirely on whether the seizure took place within the context of judicial proceedings.

In sum, although doctrinally unclear, there are strong arguments that suggest that CBRs are among the most strongly protected categories of State property. Despite the uncertainty, the possibility of being held liable for breaches of sovereign immunity significantly restricts any interference by the EU or its Member States (MS).

Assuming, for the sake of argument, that the seizure of CBRs implicates and breaches the customary international law norms of sovereign immunity, this would implicate the international responsibility of the home State or international organisation. It would give Russia a claim for reparations, creating significant financial risks. This risk is particularly acute for MS such as Belgium, where large volumes of these assets are held.

2.2 Countermeasures: Can the Seizure of Russian CBRs be Justified?

When a State or an international organisation has breached their obligations under international law, they, in principle, incur so-called international responsibility for this breach. Such responsibility creates several new obligations, such as the obligation to cease the wrongful act and to pay reparations to the injured State. In this case, if Belgium were to seize Russian CBR assets in violation of sovereign immunity, Belgium would incur international responsibility and would be obliged to pay reparation to Russia. However, under the law of State responsibility, the legal regime that governs this "procedure", there are several circumstances that can preclude the wrongfulness of an act. Put simply, there are ways to justify a breach of Russia's sovereign immunity. These circumstances are listed in Chapter V of the International Law Commission's Articles on State Responsibility (ARSIWA). These Articles reflect the status of customary international law and thus are helpful to understand these circumstances that preclude wrongfulness.

In the context of freezing or seizing CBRs, the

most important circumstance is the concept of countermeasures found in Article 22. This concept, its limits, and its implications for the freezing or seizing of CBRs will be discussed below.

Countermeasures refer to non-forcible measures taken by a State in response to an international wrongful act of another State, aimed at achieving cessation or reparation. Simplified, this argument goes as follows: Because Russia has invaded Ukraine and thus violated its obligation not to use force against another State, Belgium and the EU are allowed to freeze and seize Russian CBR assets as a sanction to bring Russia to stop its invasion. However, international law is (unfortunately) not this straightforward. It places strict limits on the use of countermeasures, in particular on who is allowed to enact countermeasures and what conditions these measures must fulfil.

The question of who can impose countermeasures is the source of a major discussion in international law scholarship. One generally distinguishes between countermeasures imposed by an injured State and countermeasures imposed by a third party. In the case of Russia, Ukraine is the injured State, while Belgium would be a third party. While the rights of injured States are fully recognised as customary international law, the right of third States to impose countermeasures is controversial. A detailed discussion on the issue of third State countermeasures would go beyond the scope of this paper, but it is important to understand that, as the law stands right now, the existence of the right to take countermeasures as a non-injured third State is highly disputed at best.

Assuming, for the sake of the argument, that both injured and non-injured States may take countermeasures, they must comply with important requirements listed in ARSIWA. Firstly, as mentioned above, a prerequisite for the imposition of countermeasures is the existence of a prior international wrongful act by the other State. Secondly, the State taking the countermeasure must have first called upon the wrongdoing State to cease its wrongful act and make reparations. Thirdly, once countermeasures are adopted, they must be proportionate, reversible, and they must be terminated as soon as the wrongdoing State resumes compliance with its international obligations.

Applying these conditions to the case of CBRs, the first and second conditions generally do not raise issues. First, Russia did breach its obligation not to use force against another State by invading Ukraine in 2014 and 2022 and second, the EU and Belgium have at multiple international fora called upon Russia to stop its invasion. However, a noticeable issue arises under the third requirement with regard to the reversibility of the countermeasure. Seizure or a permanent transfer of CBRs is difficult to reconcile with the requirement of reversibility, as it entails a permanent transfer of title that cannot easily be undone once the assets are used.

Thus, while countermeasures offer a potential legal escape for the EU and Belgium, their strict conditions, in particular reversibility and the uncertainty of third State countermeasures, severely restrict the EU's and Belgium's ability to rely on them to justify a seizure of Russian central bank assets. Once again, even though a clear legal answer is absent, the legal ambiguity creates financial risks for Belgium, potentially

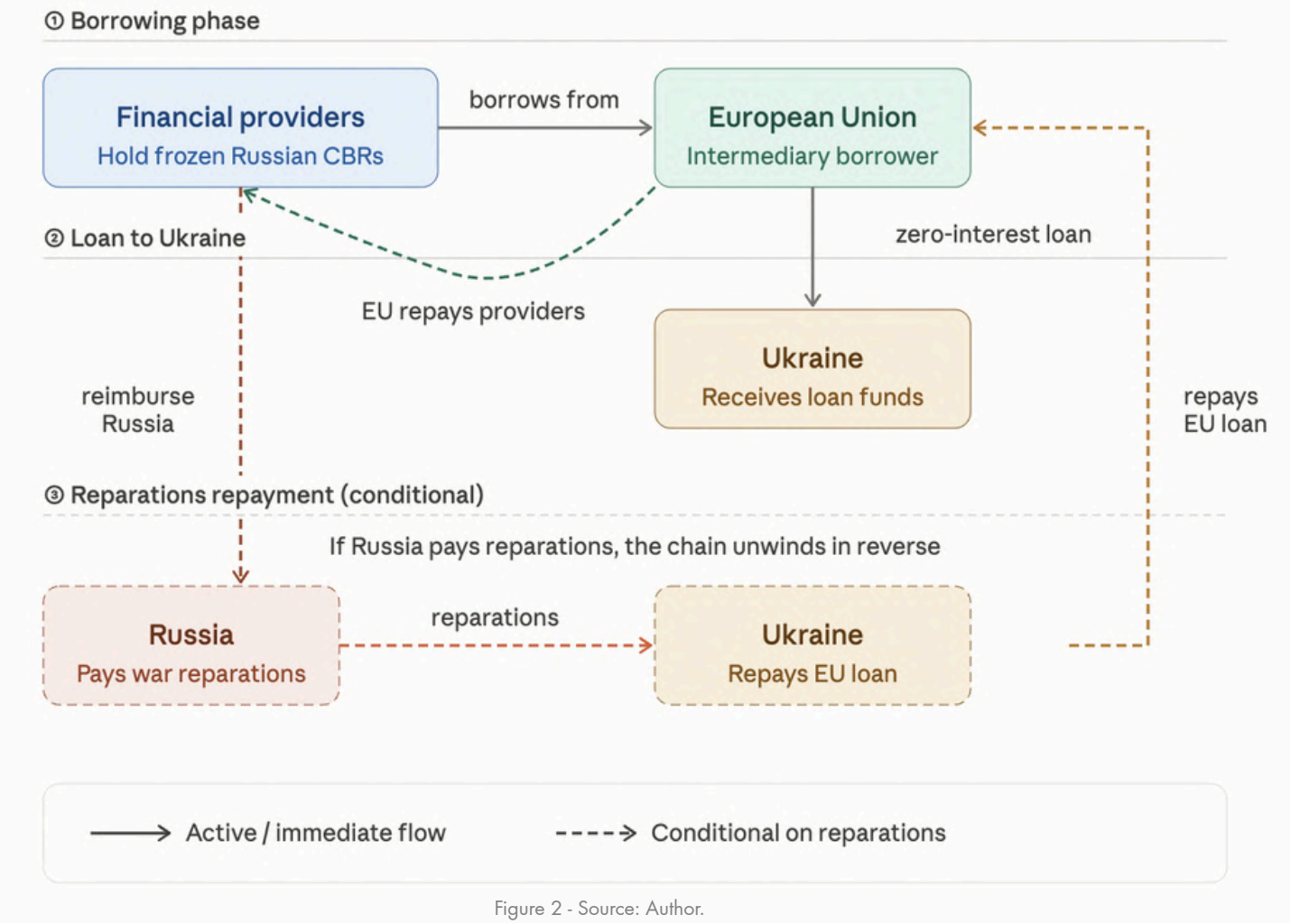


Figure 2 - Source: Author.

requiring it to repay the seized assets and pay compensation.

3. The EU's Proposed Workaround: The Failure

The legal ambiguities that surrounded the seizure of Russian assets were the ultimate reason for the abandonment of the idea of outright seizing Russian central bank assets. Against this background, the EU's approach must be understood not as an attempt to seize these assets, but as an effort to achieve similar economic effects while remaining within these legal limits.

The EU's proposal focused on achieving a reversible mechanism, which is a central requirement under the law of countermeasures, while nevertheless allowing it to use Russian frozen assets to finance Ukraine's war effort. Under the EU's proposal, the EU would borrow the money from the financial service providers that held the Russian CBRs. The EU would then provide this money as a zero-interest loan to Ukraine. If Russia were to pay Ukraine war reparations, which the EU and the G7 insist on, Ukraine would use these reparations to repay the loan to the EU, which in turn would repay its loan from the financial service providers. These providers can then reimburse Russia. This proposal would prevent outright seizure of the assets, which, as shown above, is legally problematic, while achieving the goal of financing Ukraine. Thus, from an international law perspective, this proposal is legally

defensible, albeit contested, as it preserves reversibility and avoids a direct transfer of ownership, even if it remains dependent on contested aspects of international law. Importantly, the underlying assets remain formally Russian property throughout this structure.

Nevertheless, this Reparation Loan scheme was ultimately rejected, in particular, due to remaining legal concerns. Although the Commission's proposal is legally defensible, it nevertheless rests on legal ambiguities, which expose Belgium to a significant financial risk if Russia were to prevail in potential legal proceedings.

4. Conclusion

The present analysis provides some crucial insights into the future of EU sanction regimes. The debate around using Russian central bank assets for Ukraine has shown that legal ceilings continue to constrain EU action, in particular where a potential illegality puts individual MS at a severe financial risk. Besides legal problems, the case of Russian central bank assets shows that the EU is aware of the potential implications of crossing the Rubicon and seizing foreign central bank reserves. This could set a dangerous legal and political precedent for future actions by other States and put EU and MS assets in danger.

Three takeaways are key from this discussion. First, international law might be under pressure in the current geopolitical climate, but it nevertheless continues to place significant constraints on States' actions, in particular in the economic and financial arena. Navigating these legal constraints while achieving the desired objectives requires legal creativity and flexibility. The Commission's original Reparation Loan scheme must be applauded for this creativity. Its ultimate failure, however, shows how acutely aware Member States are of the financial risks involved in interfering with foreign central bank reserves. Second, actions against foreign central bank reserves are integrated within a broader set of financial sanctions. Many of these revolve around restricting Russia's access to financial infrastructure and trade. These measures raise fewer issues under international law. If combined effectively, the lawful freezing of central bank reserves can be sufficient to achieve the desired effect without needing to outright seize these assets. Finally, the case of Russian central bank reserves demonstrates that international law does not merely limit State action, but it actively shapes the architecture of financial sanctions.

References

- United Nations Convention on Jurisdictional Immunities of States and Their Property (adopted 2 December 2004, not yet in force) UN Doc A/59/508

- James Crawford, 'Brownlie's Principles of Public International Law' 489–490.

- Tom Ruys, 'Immunity, Inviolability and Countermeasures - A Closer Look at Non-UN Targeted Sanctions' (Social Science Research Network, 19 June 2018) 10 <https://papers.ssrn.com/abstract=3198688> accessed 9 February 2026.

- UN Convention on State Immunities. International Law Commission, Draft Articles on Jurisdictional Immunities of States and Their Property, with Commentaries (1991) II(2) YBILC 13 art 1 para 2

- Questions Relating to the Seizure and Detention of Certain Documents and Data (Timor-Leste v Australia) (Memorial of Timor-Leste, 28 April 2014), paras 5.18 and 5.47

EPIS Consult

EPIS Consult Career Seminars

Your graduation is approaching. You take your last exams, finish your thesis, plan your defence. While uni life winds down, one question grows more present: ***What next?***

Transitioning from university into a career in international relations can feel daunting. This is where our **Career Seminar** comes in.

You will gain practical insights into IR career paths, sharpen the soft skills employers look for, and learn how to build a profile that stands out in a competitive field. Whether you are aiming for policy, research, international organisations, or beyond, our seminar helps you take the next step with clarity and confidence.

➡ ***More details coming soon.***

Upcomming Seminars

Berlin: **September 15**
Brussels: **March 15**

These dates are tentative; we will announce further details later.

Security Sector Update

EPIS Consult bridges talent and expertise.

For students, we offer **career seminars** that translate academic knowledge into professional pathways.

For companies, we provide concise **updates** and **analysis** on key developments in the **security** sector.

Watch this space as we continue to expand and shape our consulting branch.



Interested in boosting your policy career ?

>> Apply for a Seminar!

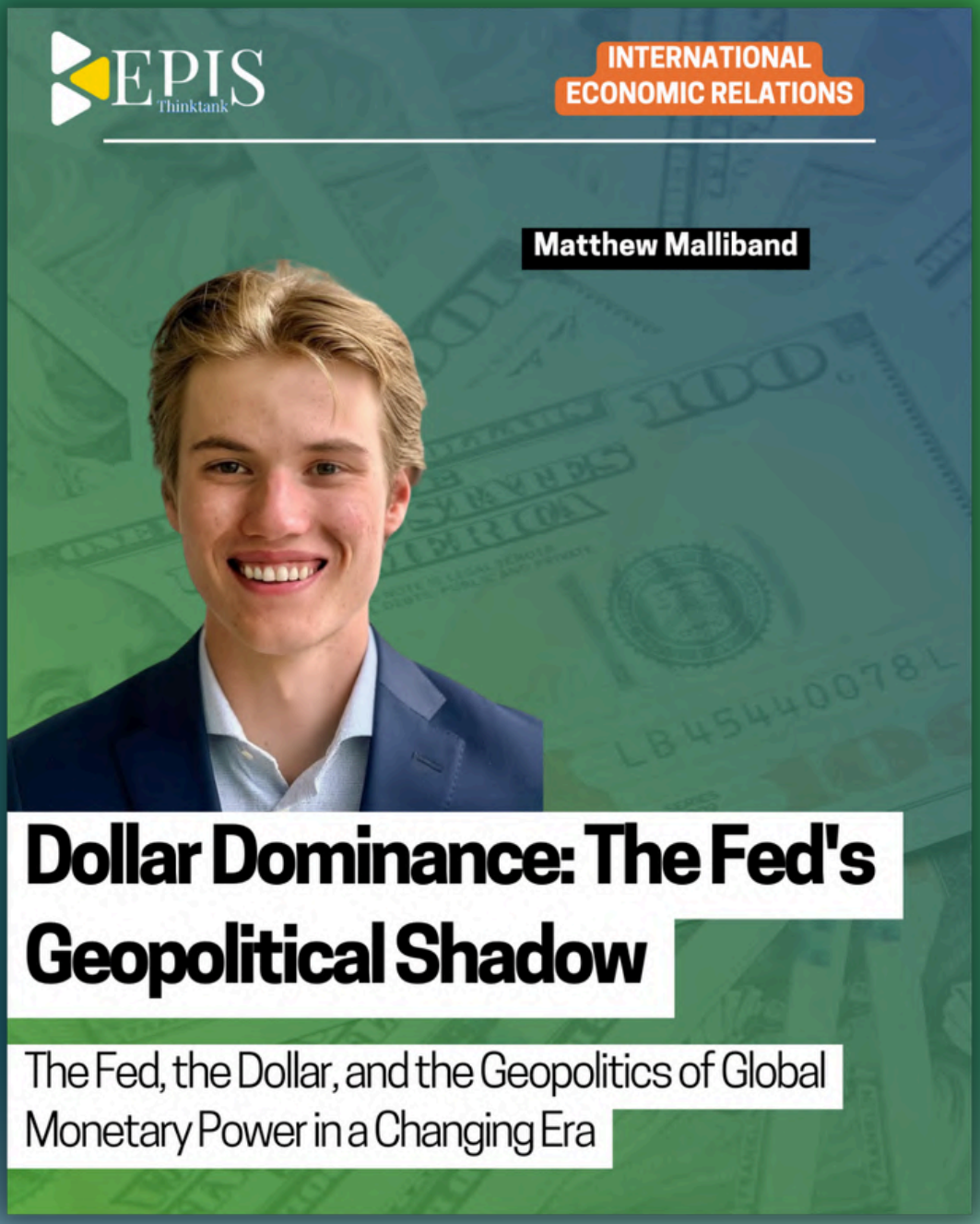
APPLY



Message Ferdinand on WhatsApp.
She gets you started:)

EPIS Consultant
+49 155 6597 5423
consult@epis-thinktank.com

Still got Questions ?



About the Article

Main Question: How does Fed monetary policy shape US geopolitical power, and what does the Powell-to-Warsh transition mean for dollar dominance? Argument: The dollar's reserve status turns every Fed decision into a geopolitical event, enabling financial sanctions while keeping BRICS alternatives marginal. Conclusion: Warsh's hawkish instincts can reinforce dollar credibility, but ultimately, his goal is not to push US geopolitical objectives.

About the Author

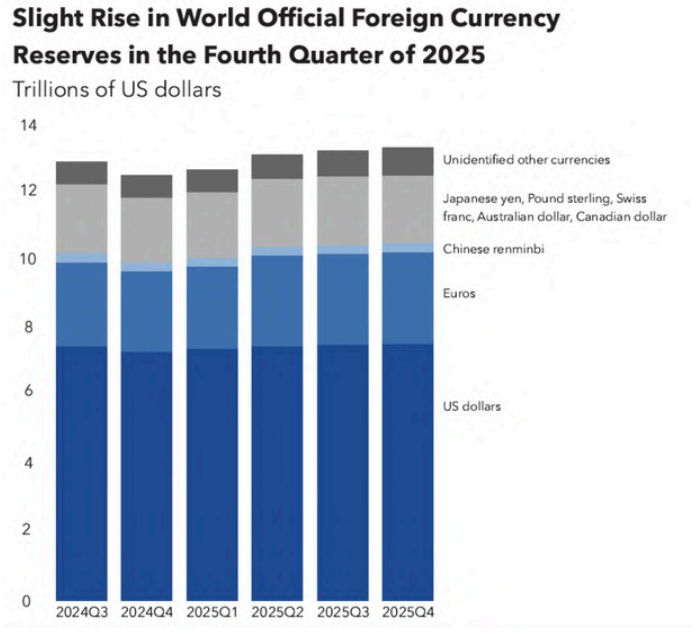
Matthew Malliband is pursuing a B.B.A. in Finance while minoring in French and International Affairs at the University of Colorado - Boulder. His interests lie in the effects of geopolitics on the global economy, driven by his previous work and study experiences on both sides of the Atlantic. He works with an African-focused development non-profit.

1. Introduction

The United States Federal Reserve's use of monetary policy has vast geopolitical effects despite the Fed's dual mandate, maintaining price stability and maximum employment. As Jerome Powell's term ends in May 2026, this raises a critical question: how do the Fed's decisions affect American monetary dominance, and how will the change of the federal chair in this current climate affect it? This article examines dollar dominance, sanctions deployment, and BRICS alternative systems.

2. US Dollar's influence and power

US Dollar geopolitical influence is caused by the strength and size of the American economy, which allows the treasury to issue treasury bonds and at a (theoretical) risk-free rate. Following the removal of the US dollar from the gold standard in 1971, which collapsed the Bretton-Woods system, the US Dollar has maintained its dominance through inertia, network effects, and the weight and size of US capital markets. The stability of the American judicial, political, and economic system has made it an attractive location for investors all around the world, pinning the US dollar as the world's reserve currency. A reserve currency is a currency held in significant quantities by governments and institutions as part of their foreign exchange reserves, used to settle international transactions and debts. Nearly 60% of global foreign exchange reserves are held in US dollars (IMF, 2026). The United States dollar's position as the global reserve currency grants Washington economic leverage and influence in international affairs. This monetary superiority allows the United States to export inflation, finance deficits at minimal cost, and use financial sanctions as a foreign policy tool without requiring military intervention.



Source Figure 1: IMF

The American economy is able to export inflation because widespread use of the US dollar as a reserve currency forces other nations to devalue their own currencies or raise interest rates to keep pace with American monetary policy. Additionally, because most global commodities like oil are priced in dollars, an increase in the U.S. money supply raises prices for foreign buyers, effectively "pushing" American price increases onto the global market. Therefore, other economies become very susceptible to US cyclical economics, which can be very damaging. This amplifies the effect on Federal Reserve interest rate decisions, creating ripple effects across global economies through capital flow reversals. Capital flows represent the movement of money for investment purposes across borders, typically seeking the highest risk-adjusted returns available globally. When the Fed aggressively raised rates in 2022-2023 to

combat inflation, emerging markets experienced significant capital outflows as investors redirected funds to higher-yielding risk free US Treasury securities, triggering currency crises in nations like Egypt, Pakistan, and Sri Lanka (Kalemli-Özcan & Unsal, 2023). Other countries' monetary policy, regardless of their goals to limit inflation or encourage employment, often mirrors the Federal Reserve's rate changes, due to the need to provide risk-adjusted government debt, relative to the United States treasury bills. This demonstrates how Fed policy functions as an involuntary external constraint on sovereign monetary policy, effectively limiting the policy actions available to central banks in the Global South.

3. Geopolitical uses of Monetary policy

A reserve currency is a currency held in significant quantities by governments and institutions as part of their foreign exchange reserves, used to settle international transactions and debts.

Financial institutions and messaging networks like SWIFT are compelled to comply with American sanctions due to US dollar dominance in global finance. Most major international banks maintain dollar-denominated accounts in New York and depend on US capital markets and clearing infrastructure. If a bank were to violate US sanctions, it would cut them off from the US financial system, and thus all of the services that the US provides. Because SWIFT facilitates payments between its member banks' New York and international accounts, it has no choice but to enforce US sanctions, often in coordination with the European Union. The risk of losing access to US capital markets and clearing systems is simply too great for most of its members to ignore. This has enabled the United States to use access to SWIFT as a weapon in times of conflict. The Russian invasion of Ukraine showcased this "financial blockade". When the EU extended Russia's SWIFT ban to a full transaction ban in July 2025, prohibiting all EU operators from engaging in transactions with 50 listed Russian banks (Albrecht vom Kolke et al., 2025), it demonstrated the coercive power of controlling financial infrastructure. This evolution from selective disconnection to comprehensive transaction prohibition illustrates how control over payment systems has become a useful instrument of economic warfare, parallel to traditional trade embargoes.

Secondary sanctions, defined as penalties imposed on third parties from neutral countries to prevent them from doing business with a primary sanctioned target, extend US policy beyond American jurisdiction. Secondary sanctions penalize third-party entities for conducting business with sanctioned targets, threatening them with loss of access to US markets or dollar clearing systems even when these activities are legal under their own national laws. Following Russia's invasion of Ukraine, European financial institutions holding exposure to Russian banks faced a choice between servicing existing Russian obligations or maintaining US market access, with most choosing the latter. US Dollar dependence turns a seemingly voluntary decision into a necessity, enabling Washington to weaponize global financial institutions as enforcement mechanisms

for American foreign policy.

While sanctioned states have developed alternative financial systems, they remain fundamentally constrained by network effects and limited adoption. Russia's SPFS system, created after 2014 Crimea sanctions, expanded to include 160 foreign banks by 2024 (Donovan et al., 2025). The SPFS system has also pursued integration with similar networks like Iran's Shetab. However, US Office of Foreign Assets Control (OFAC) warnings in November 2024 about foreign financial institutions joining SPFS significantly deterred adoption, as potential participants weighed limited trade benefits with Russia against the loss of US Dollar access (Office of Foreign Assets Control, 2024). This reach of dollar-based systems and the fragmented nature of alternatives ensures that workarounds remain expensive, slow, and confined to relatively small volumes of trade between sanctioned states, leaving the dollar's structural dominance largely intact.

US Dollar dependence turns a seemingly voluntary decision into a necessity, enabling Washington to weaponize global financial institutions as enforcement mechanisms for American foreign policy

4. Challenges to US Monetary dominance

BRICS de-dollarization efforts reveal the gap between geopolitical ambition and economic realism among member states. At the 17th BRICS summit in July 2025 in Rio de Janeiro, despite previous talks about creating alternatives to dollar dominance, the 126-point final declaration made no mention of a common BRICS currency or unilateral de-dollarization strategy (Tripathi et al., 2025). India explicitly distanced itself from the US Dollar replacement efforts, with External Affairs Minister Jaishankar declaring the dollar "the source of global economic stability" that the world needs more of, not less (Pistilli, 2026). This retreat from de-dollarization ambitions demonstrates the network effects of US Dollar dominance. When combined with threats of market access denial, it maintains the status quo even among those critical of American financial dominance.

Alternative payment systems have grown but remain smaller than dollar-dominated infrastructure like SWIFT. China's Cross-Border Interbank Payment System (CIPS) processed 6.6 million transactions worth approximately $17 trillion in 2023, representing a 27% annual increase (People's Bank of China, 2023). According to their January 2025 announcement, CIPS has expanded to 1,467 indirect participants across 119 countries (Cross-Border Interbank Payment System, 2025). However, these figures pale in comparison to SWIFT's 44 million daily messages and the trillions processed through dollar clearing systems each day. The infrastructure exists for an alternative to rise, but not enough displace for a complete transformation of US monetary dominance.

Recently, central bank gold reserves have risen as a hedging strategy against dollar exposure, rather than an alternative to US Dollar reserves. BRICS+ (BRICS and Egypt, Ethiopia, Iran, Saudi

Arabia, the United Arab Emirates, and Indonesia) central banks aggressively purchased 800 metric tonnes of gold in 2025, bringing combined gold reserves above 6,000 tonnes and keeping consistent with similar trends of building up gold reserves from recent years (Keskin, 2025). This coordinated buying has pushed gold prices to record highs of approximately $4,400 per ounce by late 2025, demonstrating market recognition of reduced confidence in dollar-centric reserve management. Yet gold's lack of yields, storage costs, and limited utility for daily transactions ensure it serves as a wealth preservation method, not an alternative currency system challenging the US dollar.

The political and economic diversity within BRICS creates coordination challenges for unified de-dollarization efforts. China seeks Yuan internationalization but refuses to abandon its controls used to maintain domestic financial stability, having experienced devastating capital flight in 2015-16, causing foreign exchange reserves to fall by $1 trillion before tightening controls in 2017-18 (Brooks, 2024). India and Brazil maintain strong ties to Western financial institutions and explicitly rejected US Dollar replacement. Russia's sanctions-driven desperation for alternatives is at odds with more cautious members. This conflict of interests, combined with the absence of any BRICS economy willing to provide the bond markets necessary for reserve currency status, ensures that de-dollarization remains limited to payment systems and bilateral agreements.

5. Beginning of a new era

Jerome Powell will leave office as the chairman



Source - Federal Reserve

of the Federal Reserve this May. The likely candidate to take his spot is Kevin Warsh. Warsh attended Stanford (BA) and Harvard (JD), worked in Morgan Stanley's Mergers and Acquisitions (M&A) department, before working in the National Economic Council in George W. Bush's administration. Warsh was nominated to the Federal Reserve Board in 2006, and at 35 years old, was the youngest appointment ever in the history of the Fed. Warsh was credited as the link between Fed chair Ben Bernanke and Wall Street due to his many contacts there, and was credited as an integral part of navigating the Global Financial Crisis (GFC). However, in the fallout of the GFC, Warsh was very skeptical of the use of Quantitative Easing (QE), due to its inflation risks, and thus he resigned from the board in

2011 (Board of Governors of the Federal Reserve System, n.d.). After his time at the Fed, he spent time back at Stanford, and on a business forum during President Trump's first term.

Despite a new Fed chair coming in for the first time in eight years, the dual mandate of the position doesn't change. Warsh's scepticism towards QE during the recovery from the GFC could imply a reluctance to expand the money supply aggressively as Fed chair. A more hawkish Federal Reserve chair can strengthen the power of the US dollar, as one of the central arguments for de-dollarization efforts is that the US could inflate its way out of debt obligations, erasing the purchasing power of dollar-based reserves. This can discourage efforts for alternatives. A commitment to price stability over economic stimulus will reinforce the dollar to reliably hold its value, and ultimately help American geopolitical interests. Whether this is Warsh's goal is beside the point, but the ripple effects will be felt by global economies. The role of the Chairman of the Federal Reserve is not to push American geopolitical goals, but every decision that the Fed makes will shape American geopolitical policies due to the size and power of American capital markets.

References

- International Monetary Fund. (n.d.). IMF data brief (March 27). https://data.imf.org/en/news/imf%20data%20brief%20march%2027
- Kalemli-Özcan, Ş., & Unsal, D. F. (2023). Global transmission of Fed hikes. Brookings Papers on Economic Activity, 2023(2), 167–208. https://www.brookings.edu/wp-content/uploads/2023/09/Kalemli_Ozcan-Unsal_16820-BPEA-FA23_WEB-updated.pdf
- Albrecht vom Kolke, M., Benson, J., Junck, R. D., Sève, M., Lainé, W., & Mueller, P. (2025, July 31). EU targets Russia's energy, financial and defense sectors in 18th sanctions package. Skadden, Arps, Slate, Meagher & Flom LLP. https://www.skadden.com/insights/publications/2025/07/eu-targets-russias-energy-financial-and-defense
- Donovan, K., Nikoladze, M., de Kruijf, L., & Tursun, N. (2025, April 17). Russia sanctions database: April 2025. Atlantic Council. https://www.atlanticcouncil.org/blogs/econographics/russia-sanctions-database-april-2025/
- Office of Foreign Assets Control. (2024, November 19). Sanctions risk for foreign financial institutions that join Russian financial messaging system, System for Transfer of Financial Messages. U.S. Department of the Treasury. https://ofac.treasury.gov/media/933656/download?inline
- Tripathi, J., Osaghae, E. E., Sager, A., & Sidiropoulos, E. (2025, July 23). The BRICS summit 2025: The challenge to find common ground. Council of Councils; Council on Foreign Relations. https://www.cfr.org/councilofcouncils/global-memo/the-brics-summit-2025-the-challenge-to-find-common-ground/
- Pistilli, M. (2026, February 24). How would a new BRICS currency affect the US dollar? Investing News Network. https://investingnews.com/brics-currency/
- People's Bank of China. (2023, June 29). 2023 Q1 payment system report. https://www.pbc.gov.cn/en/3688241/3688663/3688681/4756460/4975391/20230629100729810016.pdf

- Cross-Border Interbank Payment System. (2025, February 10). CIPS Participants Announcement No. 105. https://www.cips.com.cn/en/2025-02/10/article_20250210103053155542.html

- Keskin, G. (2025, July 1). Weaponized finance: Sanctions, SWIFT, and the future of global political risk. https://atlasinstitute.org/weaponized-finance-sanctions-swift-and-the-future-of-global-political-risk/

- Brooks, R. (2024, July 4). China's Achilles' heel: Capital flight. Brookings. https://www.brookings.edu/articles/chinas-achilles-heel-capital-flight/

- Board of Governors of the Federal Reserve System. (n.d.). Kevin M. Warsh. Federal Reserve History. https://www.federalreservehistory.org/people/kevin-m-warsh

March 2025

EPIS

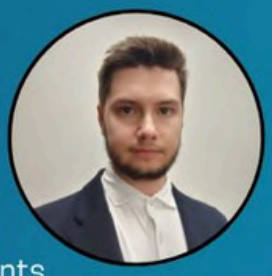
The EPIS Newsletter brings together the latest insights and publications from our Thinktanks, the EPIS Network, and EPIS Consult. Stay engaged and join the conversation!

Follow Us

Graduated from uni, took a new photo, or need account access?

Notify us via WhatsApp
+49 15565 975 423

Fellow of the Month



Teodor Dragon is our Fellow of the Month! Over the last few months, our technical affairs team worked on technological improvements to the website. Thanks to Teodor's work, we could further automate our membership management. You can now update your bio via our chatbot and see it on our website within 24h!

Board of Directors



Welcome to our External Affairs Team, **Dunja Boukricha** and **Kaya Koral**! They will help us reach out to experts to get your voices heard. Also, under the lead of **Gidi Brandes**, we now also have a dedicated Netherlands chapter!

Board of Advisors



Anneli Jäätteenmäki is a Finnish politician who served as the first female Prime Minister of Finland in 2003. She also served as a Member of the European Parliament and was a Vice-President of the European Parliament between 2012 and 2014.

Interested in learning more about our board of advisors and in contributing to our work?
Become a Think Tank Fellow Now!

Viewer Stats

- ▲ 49,959 (+0.7%)
- ▲ 37,440 (+19.1%)
- ▲ 16,515 (+2.6%)

EPIS Track Record

Journal Database
Accesible insights at your fingertips

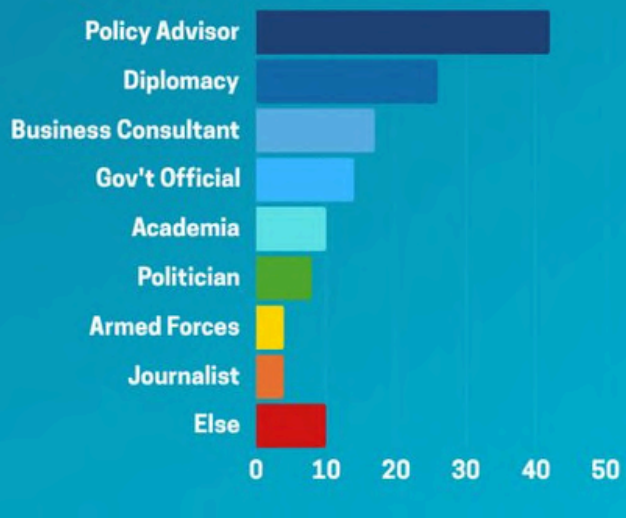


Website Update
Update your info in real time!



Question of the Month

What is your dream career path?





About the Article

Should the ECB push the Euro internationally to incentivise smaller economies to take the Euro on as their anchor currency? The general trend point towards a de-risking internationally with countries increasingly preferring baskets over a single currency, and the most attractive policy remains domestic stability. The ECB should not let itself be distracted by geopolitical opportunism and rather focus on domestic price stability.

About the Author

Martin Indjov is a student of International Relations and Organisations at Leiden University with broad knowledge of the international political environment. His interests focus on economics and international relations in Europe and Eurasia. Passionate about improving people's lives, Martin is eager to join EPIS and contribute to its mission.

International monetary policy is dominated by the US Dollar, hence why the current international system is commonly referred to as the dollar hegemonic system (Boz et al., 2025; Goldberg & Ravazzolo, 2022; Kawai & Akiyama, 1998; Zoffer, 2019). But why is the Dollar so dominant? After all, almost every country has its own currency. It all has to do with the US' historical role as the global hegemon and the general lack of trust between countries (Boz et al., 2025). For example, let us look at a country such as Brasil: it may want to engage in trade with Nigeria, but how can both sides agree on a price in one of their currencies that leaves no room for scepticism about the other party's actions and intentions? The answer is that they cannot - at least not in their respective currencies, so they turn to a third currency which they both recognise to be reliable, the US Dollar. As the currency of the global hegemon, it represents the perfect intermediary for both, facilitating agreement between them and enabling thereby trade (Casas et al., 2016; Kawai & Akiyama, 1998; Salant, 1964). Naturally, other currencies like the Euro, or the Japanese Yen also play a big role internationally, but if international trade happens, chances are it is conducted in USD (Boz et al., 2025; Casas et al., 2016). Moreover, the current dollar hegemony does bring substantial benefits for smaller and developing economies. These can come in the form of lower transaction costs and a simplification of international trade (Casas et al., 2016; Kawai & Akiyama, 1998). Additionally, such countries may benefit from easier access to markets, especially if foreign actors do not trust the local currency (Casas et al., 2016). Hence, it seems that there are many benefits from attaching the local currency to the dollar, but are there really only benefits of this process and can the Euro step up enough to be an anchor to these countries?

Anchor currency: The currency to which the local one is pegged

In this article, we will define what anchor currencies are, and in doing so we will also look into both their upsides and downsides. Furthermore, we will explore the processes from which countries may seek to decouple in order to reduce their Dollar dependency. Additionally, we will look into ways that EU monetary policy can be shaped in order to be more attractive internationally. And finally, we will take a look at what the future could hold for such economies and European monetary policy broadly.

There are certainly prominent voices calling for an end to the dollar hegemony and a beginning of a euro hegemony (Koranyi, 2025; Lagarde, 2025). Nonetheless, in order to best grasp this complex topic some things may need clarification. One of the first things that need to be defined is what anchor currencies actually are. In simple terms, an anchor currency is the currency to which the local one is pegged (Currency Pegging, 2024). In the post Bretton-Woods economic order this used to be synonymous with the gold standard, which was the pegging of the US Dollar to gold in a 1:1 exchange rate (Ghizoni, 2013). This system made gold the global back-up currency. However, since Richard Nixon disbanded this system due to inflationary pressures and a

looming gold rush which would have crashed the dollar, the US Dollar became the de facto back-up currency globally. (Costigan et al., 2017; Ghizoni, 2013; Kawai & Akiyama, 1998; Salant, 1964).

It is important to understand that the dominant role of the USD is no accident, quite the opposite. The crucial role the dollar plays internationally has always been a key for the United States in order to exert their power as global hegemon and to ensure that their position within the international system will not be challenged (Costigan et al., 2017; Kawai & Akiyama, 1998). However, this does not mean that they did not allow any other currency to gain relevance or to be a somewhat significant actor internationally, as can be seen by the popularity of the British pound in the 50s and 60s, and subsequently by the French franc and German mark in the 70s, 80s, and 90s (Meissner & Oomes, 2009). Their relative popularity was tolerated because these countries were not seen as a threat to American hegemonic power (Costigan et al., 2017; Meissner & Oomes, 2009). Figure one is a historic visual representation of the distribution of choices made by countries with regards to pegging their currency to a foreign one or in some cases to have a floating exchange rate (Meissner & Oomes, 2009). A way to interpret this graph could be that since the majority of reserve currency has historically been held in USD, international governments trust it to keep its value and importance the most. Figure two brings this analysis into the present day. There it can be observed that the dollar may have somewhat lost its role as the unchallenged number one when it comes to international trade (Brüggen et al., 2025). However it is still the go-to currency for countries looking to engage in economic relations, as largely only EU countries use the euro for international trade and "third" countries prefer the dollar, this includes countries like Sweden, Romania, Poland, and others who are member states but do not use the euro, and Denmark who has a more special relationship with the euro due to the Danish Krona being pegged to the euro. Naturally there are exceptions to the euro as a smaller currency internationally, an example of which is the CFA franc which is a currency used by fourteen African countries with their currency being pegged to the euro. However even this exception proves that the euro plays a secondary role internationally, as even with this peg most of the trade of these countries is not conducted with the EU and therefore likely to be invoiced in USD (Sylla, 2026). Therefore, while significant due to the size of the EU economy, the euro does not quite have the international relevance needed to credibly challenge the Dollar.

Figure 1. All Countries: Anchor Currency Choices, 1950–2001
(Percentage of countries)

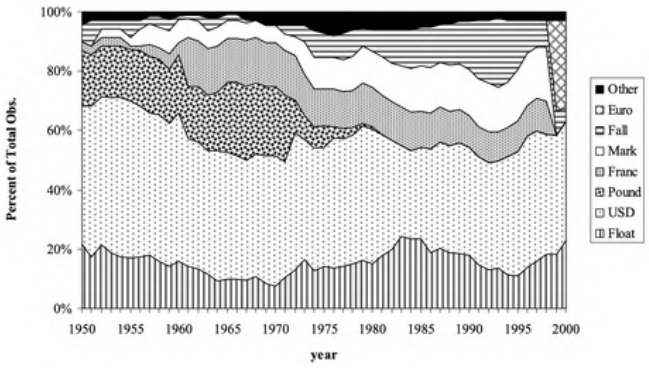


Figure 1 source: Meissner & Oomes, 2009

Nonetheless, the US was most certainly willing to spread and popularise the usage of the USD as the global anchor currency in other areas of the world, particularly South America and Asia (Quah, 2013). While it should be obvious that such an international economic policy was not just pursued out of the goodwill of American

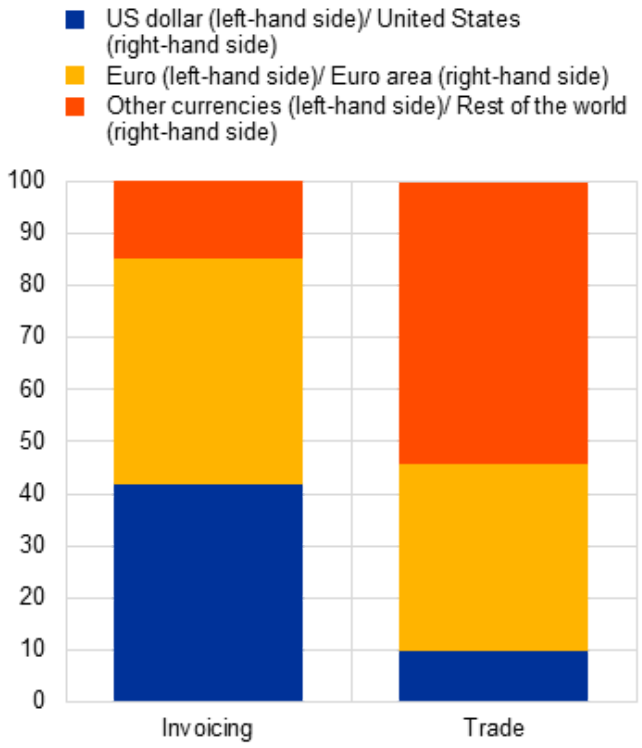


Figure 2 source: Brüggen et al., 2025

administrations, it must be added that the US Dollar as a de facto anchor currency brought many benefits to countries in those regions (Kawai & Akiyama, 1998; Meissner & Oomes, 2009). Oftentimes American companies are some of the biggest companies in their respective sector, and naturally, they conduct trade in USD. Therefore, anchoring the local currency to the dollar can facilitate trade with such companies, and since other small and developing countries are also incentivised to pursue the same economic relations and partnerships, trade between these countries also becomes easier (Boz et al., 2025). An additional benefit of anchoring around a currency, and especially around the dollar, is the exchange rate stability that comes with the pegging of one's own currency to another one (Casas et al., 2016). These benefits, in addition to those mentioned in the introduction, show that anchoring one's own currency to the USD was a beneficial policy to follow for small and developing economies.

Naturally, there are also some downsides to a Dollar-centred trade for these economies. A big risk that these countries may face is that of local dollar shortages which may make them unable to conduct trade. An example of this is when Sri Lanka faced a dollar shortage in 2022, forcing its economy into a crisis (Kumar et al., n.d.). Furthermore, the economy of a country is being made very dependent on US monetary policy, which typically does not include them as a priority. These hypothetical and real-world scenarios expose that perhaps being overly dependent on the USD for international trade is not the best way for small and developing economies to propel their growth. Therefore the logical response that we can observe, is a reduction and diversification of the dependency on the dollar (Brüggen et al., 2025; Erbenova et al., 2016). It must be clarified that countries may not want to lose out on the substantial benefits that may come with anchoring their own currency around another major currency, but instead they may simply wish to reduce their own dependency on the USD. This most often than not takes the form of abandoning the single anchor in favour of a currency basket. Notable examples of such action include Singapore and Kuwait who use a diverse mix of multiple currencies which include the euro and the dollar among a variety of others (Central Bank of Kuwait, 2007; Monetary Authority of Singapore, 2025). In their case, switching their anchors helped these countries accelerate their economic growth (Chow, 2023). In an increasingly multipolar world where questions on American reliability and stability become ever louder, more and more countries may be tempted to follow on this path and look to diversify their currency anchors. This presents the EU with a golden opportunity not only to increase its international standing and

but also to assist small and developing countries in their economic development.

But why would the EU, or more accurately the European Central Bank (ECB) pursue a policy which explicitly tries to make the euro more internationally appealing? One possible motive which could be very likely found within key institutional actors is to essentially try to take the dollar's place internationally and become 'a' or 'the' global reserve currency. The President of the ECB, Christine Lagarde, has recently come out and said that "a shifting geopolitical landscape could open the door for the euro to play a greater international role" (Taylor, 2025, para. 6). The benefits of the euro playing a bigger international role are clear and mirror those that the US is currently enjoying with its dominance of the dollar, namely: an increase of geopolitical autonomy, but also a dramatic increase in international coercion power (Lagarde, 2025; Zoffer, 2019). From an economic perspective, this could also bring many benefits as an internationally more relevant currency by definition means an increased foreign demand, this would further be accompanied by lower sovereign borrowing costs (Lagarde, 2025). This could boost and stabilise the EU's economic position and make it more resilient against external shocks. Overall the potential benefits of increased monetary relevance on the world market are substantial and so are the geopolitical implications. Therefore taking firm action along a clear long-term goal may have great influence in the world.

With countries reorienting their monetary policy, the ECB stands at a crossroads having to choose whether to appeal to international actors or to keep its focus on "domestic" monetary policy.

However, what does this mean for the future of European monetary policy? Current trends point towards the ECB prioritising credibility and liquidity as its main goal (National Bank of Belgium, 2026). Additionally, the broader trend among developing economies continues to be one of more flexible regimes, with forms such as currency baskets instead of one single currency as an anchor being more popular as of late (Levy-Yeyati & Sturzenegger, 2024). Such a trend has its merits as countries will naturally seek to not overly expose their monetary policy to foreign actors who may not consider their interest when deciding monetary policy. Taking these factors into account, it becomes clear that it would be nonsensical for the ECB to actively and aggressively push for smaller and developing economies to take on the euro as their sole anchor currency. This is because first of all there is simply not enough demand from third countries to take on the Euro as their anchor currency, and it is questionable whether such demand could reasonably be induced. Secondly, the mandate of the ECB is first and foremost focusing on price stability within the eurozone. Shifting focus, or signaling intentions to shift focus away from this central goal could be seen as a reprioritisation of the ECB away from EU citizens and towards far away abstract foreign interest for unclear reasons. If the ECB would have the serious ambition of becoming an internationally dominant currency player, then it should prioritise ensuring a stable monetary policy and governance at home. In this manner, it will automatically show to international actors

that the euro can be relied upon, both in economic booms as well as in recessions. Considering all of these points, we can observe that the ECB is indicating that it is moving along these policy lines in recent public statements, prioritising "domestic" policy.

In conclusion, we have established what anchor currencies are and how they can both benefit but also be a burden to a small and developing countries' economy. Further we have explored that the US with its dollar is the main provider of global currency and therefore also the main beneficiary of the status quo. Following that we have explored current international monetary trends and possible steps that the ECB may wish to take in order to position itself in the international world. After that we have arrived at the conclusion that the ECB should refrain from structuring its monetary policy too far outward and instead continue to deliver results within its own "territory". We have concluded that this is the best way to ensure economic stability within the eurozone, which is exactly what attracts international actors, in case their motives influence the decisions taken by the ECB.

References

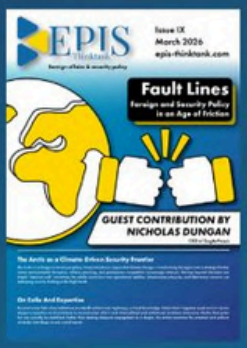
- Ghizoni, S. K. (2013, November 22). Nixon Ends Convertibility of U.S. Dollars to Gold and Announces Wage/Price Controls. Federal Reserve History. https://www.federalreservehistory.org/essays/gold-convertibility-ends
- Goldberg, L., & Ravazzolo, F. (2022). The Fed's International Dollar Liquidity Facilities: New Evidence on Effects (No. W29982; p. w29982). National Bureau of Economic Research. https://doi.org/10.3386/w29982
- Koranyi, B. (2025, May 26). Euro could become the dollar's alternative, Lagarde says. Reuters. https://www.reuters.com/world/europe/euro-could-become-dollars-alternative-lagarde-says-2025-05-26/
- Kumar, U., Fernando, L., & Kariyawasam, N. (n.d.). Asian Development Outlook April 2023. Asian Development Bank. Retrieved https://www.adb.org/sites/default/files/publication/863591/sri-ado-april-2023.pdf
- Lagarde, C. (2025). Europe's "global euro" moment. https://www.ecb.europa.eu/press/blog/date/2025/html/ecb.blog20250617~7de14a39c3.en.html
- Levy-Yeyati, E., & Sturzenegger, F. (2024). Exchange Rate Regimes 20 Years Later: The Prevalence of Floats. IMF Economic Review. https://doi.org/10.1057/s41308-024-00266-7
-
- Meissner, C. M., & Oomes, N. (2009). Why do countries peg the way they peg? The determinants of anchor currency choice. Journal of International Money and Finance, 28(3), 522–547. https://doi.org/10.1016/j.jimonfin.2008.08.007
- Monetary Authority of Singapore. (2025, May 23). FAQs on Singapore's Monetary Policy Framework. https://www.mas.gov.sg/monetary-policy/singapores-monetary-policy-framework/faqs
- National Bank of Belgium. (2026, February 5). ECB leaves interest rates unchanged. https://www.nbb.be/en/news-events/news/monetary-policy-decisions-february-2026
- Quah, C.-H. (2013). Potential currency areas in East Asia using United States, Japan or China as the monetary anchor. 1665-2045. http://repositorio-digital.cide.edu/handle/11651/3545

- Salant, W. A. (1964). The Reserve Currency Role of the Dollar: Blessings or Burden to the United States? The Review of Economics and Statistics, 46(2), 165–172. https://doi.org/10.2307/1928182
- Sylla, N. S. (2026, January 6). A Shameful Anniversary: The CFA Franc at 80 – IDEAs. https://www.networkideas.org/2026/01/06/a-shameful-anniversary-the-cfa-franc-at-80/
- Taylor, C. (2025, May 30). Why Lagarde's euro ambition could be a threat to King Dollar. CNBC. https://www.cnbc.com/2025/05/30/could-the-euro-topple-the-us-dollar-as-the-worlds-reserve-currency.html
- Zoffer, J. P. (2019). The Dollar and the United States' Exorbitant Power to Sanction. 113, 152–156. https://doi.org/10.1017/aju.2019.19
- Boz, E., Brüggen, A., Casas, C., Georgiadis, G., Gopinath, G., & Mehl, A. (2025). Patterns of Invoicing Currency in Global Trade in a Fragementing World Economy. International Monetary Fund.
- Brüggen, A., Georgiadis, G., & Mehl, A. (2025). Global trade invoicing patterns: New insights and the influence of geopolitics. https://www.ecb.europa.eu/press/other-publications/ire/article/html/ecb.ireart202506_02~a8e66f5ea3.en.html
- Casas, C., Díez, F. J., Gopinath, G., Gourinchas, P.-O., & Plagborg-Møller, M. (2016). Dominant Currency Paradigm (SSRN Scholarly Paper No. 2887205). Social Science Research Network. https://papers.ssrn.com/abstract=2887205
- Central Bank of Kuwait. (2007, May 20). 20.05.07 | The Kuwaiti Dinar (KD) Re-Pegged to a Basket of Currencies. https://www.cbk.gov.kw/en/cbk-news/announcements-and-press-releases/press-releases/2007/05/200705200000-the-kuwaiti-dinar-kd-re-pegged-to-a-basket-of-currencies
- Chow, H. K. (2023, July 24). A balancing act: How Singapore's policies reduce risk and control inflation | City Perspectives. Singapore Management University. https://cityperspectives.smu.edu.sg/article/balancing-act-how-singapores-policies-reduce-risk-and-control-inflation
- Kawai, M., & Akiyama, S. (1998). The Role of Nominal Anchor Currencies in Exchange Rate Arragements. *Journal of the Japanese and International Economies*. https://pdf.sciencedirectassets.com/272327/1-s2.0-S0889158300X00135
- Costigan, T., Cottle, D., & Keys, A. (2017). The US Dollar as the Global Reserve Currency: Implications for US Hegemony. World Review of Political Economy, 8(1). https://www.jstor.org/stable/10.13169/worlrevipolicon.8.1.0104
- Currency Pegging. (2024, November 4). Familiarize Docs. https://docs.familiarize.com/glossary/currency-pegging/
- Erbenova, M., MErbenova@imf.org, Liu, Y., YLiu@imf.org, Kyriakos-Saad, N., NKyriakos-Saad@imf.org, Mejia, A. L., AMejia@imf.org, Gasha, J., JGasha@imf.org, Mathias, E., EMathias@imf.org, Norat, M., MNorat@imf.org, Fernando, F., FFernando@imf.org, Almeida, Y., & YAlmeida@imf.org. (2016). The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action. Staff Discussion Notes, 16(06), 1. https://doi.org/10.5089/9781498375092.006l

EPIS Thinktank

Foreign Affairs & Security Policy

Recent Publications



In March, we released the 9th issue of the EPIS Magazine. This time, we dive into the **emerging role of the Arctic** and explore a **new security perspective** on the **Mediterranean**. This issue also features an exciting guest contribution by our advisor **Nicolas Dungan**!

Give it a read on our website!
>> EPIS Magazine

Recent Accomplishments

EPIS is taking over Paris: last month, we sent a large delegation to the **Paris Defense and Strategy Forum**!



Articles of the Month

EPIS Report Groups

When Aid Becomes a Weapon: The Impact of the 2021 Military Coup on Humanitarian Assistance in Myanmar
Angelina Schülke & Will Pujol

War Economy in Practice: UNAC's Foreign Dependencies and Financial Struggles Amid Sanctions and State Support
Krisztina Galos

EPIS Format Groups Magazine

EPIS Working Groups

Maternal Mortality as Foreign Policy Failure: Sudan's conflict reveals systemic gaps in global protection of maternity care
Amelia Goss & Tiana Lemarchand

Upcomming Publications

Next month, we will release the first issue of our EPIS Report on Artificial Intelligence & Cybersecurity.
Stay tuned!

EPIS Thinktank Report Groups

Join Us

Want to author the next EPIS Publication?

>> Apply for FASP Now!





Message Theodor on WhatsApp.
He will assist you :)

EPIS FASP Leader
+49 155 6597 5423
fasp[at]epis-thinktank.com

Still got Questions ?



About the Article

Main question: Why has the euro's monetary power not translated into full EU strategic autonomy? Argument: While the euro functions as a growing geoeconomic tool (sanctions, trade, finance), its impact is constrained by EMU's incomplete architecture, dollar dominance, and fragmented political and financial integration. Conclusion: Without deeper fiscal, financial, and political union, the euro cannot fully rival the dollar or deliver true strategic autonomy.

About the Author

Yann Sydow is a Master's student in European and International Affairs at the CIFE European Institute, focusing on Euro-Mediterranean cooperation. He holds a BA in European Studies from Maastricht University, specializing in EU foreign policy. His research centers on the EU's Neighbourhood Policy, enlargement, and external relations. He has acquired academic and field experience through study programs in Kosovo, Chile, and Tunis, among others, and aims to pursue a career in foreign policy.

Introduction

Since the Bretton Woods era, the international monetary system has been dominated by the dollar. Besides its key role as a medium of exchange, it serves as the world's principal reserve currency, unit of account, safe assets and the centre of global trade and financial stability (Bertaut et al., 2025). At the turn of the century, however, the unthinkable happened. After nearly 30 years since the launch of the idea of a European currency, the European Union (EU) introduced the Euro, thereby becoming the world's second biggest currency overnight (Council of the European Union, n.d., a). What at first appeared as deepening European integration, soon became a political statement: a bid for monetary autonomy and a key contender against the U.S. dollar. European policymakers such as former European Central Bank (ECB) president Duisenberg made it clear that the new currency would "set to play an important role, both in the euro area and beyond" and that it "fulfils the necessary conditions to be a leading international currency with the US dollar" (Duisenberg, 1999).

Twenty-five years later, however, this ambition appears only partially fulfilled. With the return to power politics, the rise of weaponized interdependence and a hostile U.S. administration that believes the EU was formed "to screw the U.S. over", the European project now finds itself in a precarious situation (Farrell & Newman, 2019; Manzanaro, 2025). Christine Lagarde, president of the ECB, has therefore called for a "global euro moment" reaffirming the EU's ambition of strategic autonomy in the realm of monetary policy (European Central Bank, 2025b). This "geopoliticisation" of the ECB in its discourse is remarkable, given that the institution has historically adopted a neutral, technocratic stance, with the treaties defining it primarily as an independent guardian of price stability (Spielberger, 2025). This leads us to the research question: Why has the euro's monetary power not translated into full strategic autonomy for the EU, despite growing ambitions to use it as a geoeconomic tool?

The essay brings about two central arguments. On the one hand, the Euro has undeniably made significant progress in becoming an important geoeconomic tool, enforcing economic influence beyond its borders. On the other hand, this influence remains structurally constrained by the EMU's incomplete institutional architecture.

1. Has the Euro become a geoeconomic tool?

1.1 Sanctions and Financial Weaponisation

The most visible form of monetary power lies in sanction policy. This includes imposing financial restrictions through asset freezes, exclusion from payment systems and limits on central bank reserves (Farrell & Newman, 2019). The EU has become a major sanctions actor, particularly following Russia's full-scale invasion of Ukraine, which has, at the time of writing, imposed 19 sanctions packages against Russia (Cardwell & Moret, 2023; Council of the European Union, n.d., b). Together with the other G7 partners, the EU immobilised over €280 billion (approximately $300 billion) in Russian sovereign assets (Caprile et al., 2025). Around €210 billion of these

assets are located within European jurisdictions, with the overwhelming majority held in Belgium through Euroclear, a Brussels-based financial market infrastructure, that has become the central repository for frozen Russian assets in Europe (Caprile et al., 2025).

Beyond asset freezes, a number of EU policymakers advocated going further by establishing a legal basis for their confiscation, arguing that these funds should be used to support Ukraine, including its reconstruction (Caprile et al., 2025; European Parliamentary Research Service, 2026). This has not materialised so far, largely because the EU's sanctions framework is highly legalised and member-state driven: restrictive measures are adopted by the Council under a rules-based process that, in core CFSP matters, requires unanimity (Cardwell & Moret, 2023). By contrast, U.S. dollar power is backed by broader executive sanctions authorities, especially under the International Emergency Economic Powers Act, which allows the President to declare a national emergency and authorise Treasury-led measures (Casey et al., 2024).

Monetary power: the ability to shape global finance through currency use, payment systems, and control over financial infrastructure.

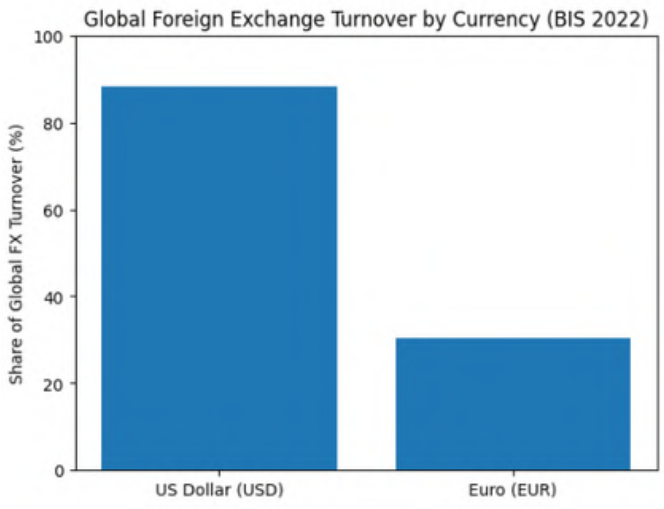
Additionally, the euro's attractiveness as an international currency rests on its "strong, rules-based institutions" where upholding "the rule of law remains essential for maintaining, and potentially increasing, global trust in the euro" (European Central Bank, 2025a, p. 2). Therefore, full confiscation would risk undermining these foundations by suggesting that reserve assets are no longer entirely neutral and secure, but may be politicised under exceptional circumstances. This could cause reputational damage and incentivise reserve diversification away from the euro (European Central Bank, 2025a; Reuters, 2025). The compromise ultimately adopted by the EU, to use the windfall profits generated by the Russian assets to support Ukraine rather than confiscating the assets themselves, captures this tension well (European Commission, 2026a). It demonstrates that euro-denominated assets can generate meaningful geoeconomic leverage but only when they fall within the EU's legal and regulatory reach.

However, the most powerful financial sanction tool of recent decades has remained in the hands of the United States, above all through the Treasury's sanctions authority and the centrality of dollar-clearing infrastructure. The U.S. dollar continues to dominate global foreign-exchange markets, for instance, in April 2025, it was on one side of 89.2% of all FX trades, compared with 28.9% for the euro (Bank for International Settlements, 2025). This dominance makes the dollar the principal vehicle currency in the international monetary system, meaning that it is used as an intermediary in transactions between parties whose own currencies are not directly exchanged (Bank for International Settlements, 2025).

This matters because many transactions between non-U.S. actors are still denominated in dollars and therefore routed through U.S.-linked financial channels, creating jurisdictional reach for

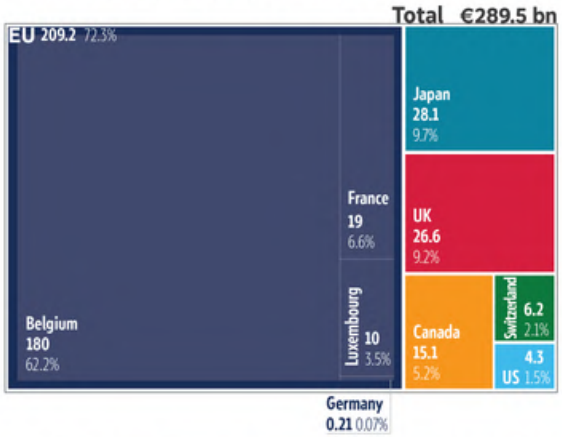
American sanctions (Farrell & Newman, 2019). As a result, exclusion from dollar clearing can inflict severe economic damage, as illustrated by the broad disruption experienced by targets such as Iran and, after 2022, Russia (Farrell & Newman, 2019). In this sense, global financial interdependence becomes asymmetrical vulnerability. By contrast, the euro gives the EU substantial coercive capacity within its own legal and financial jurisdiction, but not an equivalent ability to deny access to the core infrastructure of global finance. This remains a structural weakness of EMU: European sanctions are consequential, yet for truly system-wide financial coercion they still depend heavily on coordination with the United States. The Russian assets case therefore underlines both the euro's growing geoeconomic relevance but also its limitations, where without the support of the U.S. dollar, it becomes difficult to create a comprehensive sanction system. This shows that the euro does not yet structurally rival the dollar as an instrument of strategic autonomy.

This matters because many transactions between non-U.S. actors are still denominated in dollars and therefore routed through U.S.-linked financial channels, creating jurisdictional reach for American



Source: Bank for International Settlements (2022)

Figure 1 – Frozen Russian assets: Main EU and non-EU jurisdictions, 2025 (€ billion)



Source: EPRS, data from PISM, Swiss Federal Government. For Luxembourg, where estimations vary from 'several billion euros to around €20 billion', the authors opted for a conservative figure (€10 billion).

Source: Caprile, Peters, & Melo Almeida (2025)

1.2 Trade, Energy and Currency Denomination

Trade invoicing is a key indicator of monetary power. The euro today accounts for roughly one-fifth of global foreign exchange reserves and a comparable share of international payments, making it the second most important global currency (European Central Bank, 2025a). Trade invoicing in the EU's sphere of influence, that is, its neighborhood, is particularly significant. One can differentiate between countries that have formal monetary agreements with the EU such as many microstates (Monaco, Andorra, San Marino, Vatican City) and those that are using the Euro unilaterally with no formal EU agreement ("unilateral euroisation") such as Kosovo and Montenegro (European Commission, 2026b). For the latter two, although the EU does not formally endorse this, primarily for legal reasons (a Member State cannot bypass the normal accession process), the EU in reality is tolerant, explicitly treating their case as a special situation rather than a model for others (Lisdero, 2022; Mathieu & Funalot, 2024). Despite these countries being small, it still shows how the Euro

is attractive beyond the eurozone. This is because it is a low-inflation and trusted currency, trade is already significant with EU member states and it prevents their governments from mismanaging monetary policy (Lisdero, 2022).

When it comes to energy markets, it is not the euro but the dollar that dominates. For decades, oil and gas contracts have been overwhelmingly dollar-denominated. Historically, this is because following the collapse of the Bretton Woods in the 70s after Saudi Arabia's oil embargo, the U.S. negotiated agreements with OPEC members whereby oil would be priced and settled in U.S. dollars and surplus oil revenues would be recycled into U.S. financial markets. This means, the euro is basically non-existent in this realm. As former Commission President, Jean Claude Juncker put it: "It is absurd that Europe pays for 80% of its energy import bill – worth 300 billion euro a year – in Since 2022, with Russia's energy weaponisation, this has not changed, rather it has further intensified energy transactions in dollars. The EU has swapped its energy dependency from Russian gas with that of U.S. Liquefied Natural Gas (LNG). For instance, U.S. LNG imports into the EU were 29% in 2021, by 2025 this number has risen to 53% (Eurostat, 2025). On the other hand, Russia's share of EU gas imports fell from 45% in 2021 to 16% in 2025 (Eurostat, 2025). So while there is ambition to become less dependent on the dollar in trade invoicing, it is hard to imagine how this will happen in the short term, mainly because switching currency would require new hedging markets, new liquidity pools and in general a new financial infrastructure which is costly.

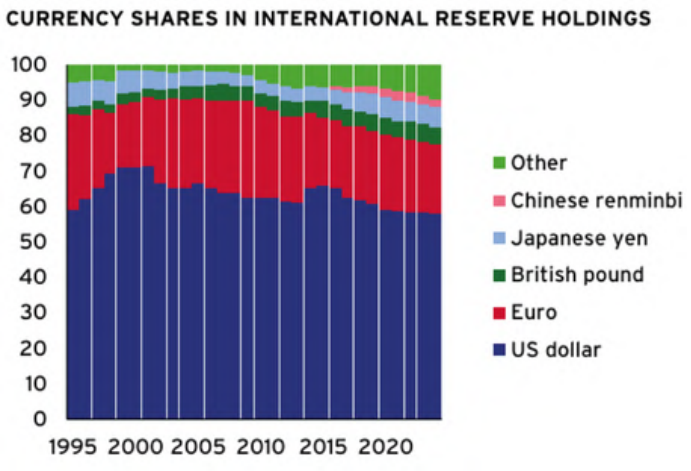
The euro functions as a geoeconomic tool—using financial mechanisms like sanctions to exert power—but its effectiveness is constrained by the EU's incomplete institutional architecture.

1.3 Financial Infrastructure and Liquidity

Many observers predicted the end of the euro in the aftermath of the sovereign debt crisis of 2009–2012. Yet the currency survived its most existential test. When Mario Draghi, then President of the ECB, declared in July 2012 that the ECB would do "whatever it takes" to preserve the euro, he restored market confidence at a critical moment (Draghi, 2012). Since then, the euro has regained and consolidated its credibility as a store of value. The ECB's decisive interventions, not only through the Outright Monetary Transactions programme, but later also through large-scale asset purchases and the pandemic emergency measures, demonstrated the institution's growing willingness and capacity to act as a lender of last resort (Cœuré, 2013; European Central Bank, n.d.). At the same time, the resilience of the euro was underpinned by the euro area's integrated financial infrastructure, particularly the TARGET2 real-time gross settlement system, which ensured the uninterrupted functioning of cross-border payments and prevented a fragmentation of monetary conditions within the currency union (European Central Bank, 2025a; European Central Bank, 2025c).

Yet, here again, comparison with the United States shows why it remains by and large asymmetric. During the 2008 financial crisis and

the Covid-19 shock, the Federal Reserve acted as the global lender of last resort (Bertaut et al., 2025). Concretely this means that dollar liquidity was supplied through extensive swap lines to central banks worldwide. This only reinforced global dependency on the dollar and showed the relevance of U.S. monetary policy. By contrast, the ECB is of relevance within the eurozone but hasn't become internationally relevant, most notably because there is no single 'euro-area treasury' equivalent to that of the United States (European Central Bank, 2025a).



Source: Bank for International Settlements (2022)

2. Structural Limits: Why Monetary Power Falls Short of Strategic Autonomy

2.1 Denomination The absence of a permanent fiscal union

For the euro to become a genuinely global currency with real geoeconomic weight, it needs more than a strong central bank. It also needs a deep, liquid and unified market for safe assets. This is one of the dollar's biggest advantages. The dollar's global standing does not rest on the Federal Reserve alone, but also on the huge and highly liquid market for U.S. Treasury securities, which remains the backbone of global reserves and safe-asset demand (Bertaut et al., 2025). By contrast, the euro still sits on top of a more fragmented bond market.

In the euro area, sovereign borrowing remains largely national (European Central Bank, 2025a). That means investors are not buying one single euro-area safe asset equivalent to a U.S. Treasury, but a range of different sovereign bonds, from German Bunds to French OATs and Italian BTPs, each with its own risk profile. This "has important economic consequences" (p.36) as it weakens the euro's capacity to offer the same scale, uniformity and instant liquidity that dollar assets provide in times of stress. This is what Lagarde means by reaching a "global euro moment" with reaching a deeper and more integrated European capital markets, a precondition for a wider international use of the euro (European Central Bank, 2025a).

There has been an important step in that direction. With NextGenerationEU, the EU was authorised to raise up to €750 billion on capital markets on behalf of the Union, creating the largest ever euro-denominated issuance at supranational level (Buti & Fabbrini, 2022). That was historically significant because it showed that common EU borrowing is possible and institutionally accepted. But it is still a temporary instrument, not a permanent fiscal architecture. For this reason, there is a disagreement whether such deepening in monetary policy is truly a paradigm shift or just a "one-off" (Buti & Fabbrini, 2022).

Such developments matter for true "strategic autonomy". In periods of uncertainty, global investors look for assets that are safe, easy to

trade and available in very large quantities. The United States can offer that through Treasuries (Bertault et al., 2025). Europe is making progress, and EU bonds may increasingly serve as a European safe asset, but without a more permanent and unified common debt framework, it will remain difficult for the euro to rival the depth and liquidity power of the dollar.

2.2 Fragmented Capital Markets and Incomplete Financial Union

Continuing this common thread, fragmentation also remains in European financial markets. While monetary policy is centralized in the ECB, financial supervision and capital markets remain to a large extent national.

Although changes have been made, especially after the terrible experience of the sovereign debt crisis, there is still no full Banking union. The Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM) have laid a considerable foundation in which the ECB now is able to supervise major euro-area banks and worst case manage banks when failing (Moloney, 2017). Yet, without a fully mutualised European deposit insurance scheme and a harmonised capital markets union it is difficult for the euro to gain leverage. Fragmentation of capital markets reduces the euro's investment attractiveness as it limits risk-sharing across member states and hinders developing large integrated financial instruments (Moloney, 2017). On the other side of the Atlantic, capital markets are unified, deep and supported by a federal fiscal regulatory framework. The key learning for a stronger euro: it needs to move beyond macroeconomic stability and institutionally create a deeper financial framework.

2.3 Fragmented Capital Markets and Incomplete Financial Union

Last but certainly not least, is politics. Monetary sovereignty is impossible without political unity. Jean Monnet, the architect of the EU believed in a neofunctionalist logic whereby integration in one sector would gradually create pressure for integration in others (Hooghe & Marks, 2009). In that sense, monetary union was never simply a technical or economic project as the ECB presents itself, but rather, it also carried a political promise. For a political federal Europe to function, one needs to go beyond monetary policy.

This political will is fragmented, best seen with the sovereign debt crisis. On the fiscally conservative side you have countries like Germany which, for instance, rejected Eurobonds; Angela Merkel calling them "economically wrong and counterproductive" (Radio Free Europe/Radio Liberty, 2012). Integrationist side, such as the Mediterranean countries, emphasise on the Union's solidarity; Monti during the crisis famously said that "we will have Eurobonds in one form or another" (Reuters, 2012). These divergences between fiscally conservative and more debt-tolerant member states over common borrowing, fiscal rules and crisis management, has created political gridlock. When national risk perceptions diverge, the consequence is further fragmentation of financial markets which ultimately threatens monetary stability.

The "multi-speed Europe" structure, with for instance six member states still outside the

eurozone, complicates the alignment of monetary and foreign policy objectives across the Union as a whole (Verhelst, 2013). A hostile world of muscle-flexing requires rapid, unified decision-making – only in such a way strategic autonomy is possible. Differing strategic outlooks create fragmentation which only benefits the EU's rivals. EMU governance is characterized by consensus among heterogeneous actors, consequently slowing down true institutional adaptation and bold reforms, particularly involving fiscality or deeper financial integration.

Importantly to mention, these limitations are not accidental. EMU was built on the idea of depoliticising monetary policy and preventing fiscal dominance. By deliberately separating the centralised monetary authority from the decentralised fiscal sovereignty, the EU was able to build a design that enhances price stability credibility yet constrains geopolitical flexibility (Moloney, 2017). This represents a paradox between its strength as a rules-based currency and the latter impeding its capacity for discretionary strategic deployment.

Policy Recommendations

- The EU should deepen euro-denominated capital markets. Advancing a Capital Markets Union would increase the supply of safe, liquid euro assets, strengthening the euro's attractiveness for global investors.

- The EU should move beyond temporary tools like NextGenerationEU Building on NextGenerationEU, the EU should consider a more permanent common borrowing capacity to enhance the depth and credibility of euro-denominated safe assets.

- The EU should invest in independent payment infrastructure. Reducing reliance on US dollar-clearing systems would strengthen the EU's strategic autonomy. Developing euro-based payment and settlement mechanisms could expand the EU's sanctions capacity, though strong network effects make this difficult in the short term.

- The EU should have greater political unity. Greater alignment among member states is essential for translating monetary power into strategic autonomy. Persistent divergences in fiscal and economic preferences continue to limit deeper integration and slow down institutional reform.

Taken together, these recommendations highlight that strengthening the euro's international role is not merely a technical challenge, but a broader political and institutional one. As Christine Lagarde emphasises, "for the euro to reach its full potential, Europe must strengthen three foundational pillars: geopolitical credibility, economic resilience and legal and institutional integrity." (European Central Bank, 2025b).

References

- Bank for International Settlements. (2022). Triennial central bank survey of foreign exchange turnover in April 2022. https://www.bis.org/statistics/rpfx22_fx.htm

- Bank for International Settlements. (2025, September 30). OTC foreign exchange turnover in April 2025. https://www.bis.org/statistics/rpfx25_fx.htm

- Bertaut, C. C., von Beschwitz, B., & Curcuru, S. E. (2025, July 18). The international role of the U.S. dollar – 2025 edition. Board of Governors of the Federal Reserve System. https://www.federalreserve.gov/econres/notes/feds-notes/the-international-role-of-the-u-s-dollar-2025-edition-20250718.html

- Buti, M., & Fabbrini, S. (2022). Next generation EU and the future of economic governance: Towards a paradigm change or just a big one-off? Journal of European Public Policy. https://doi.org/10.1080/13501763.2022.2141303

- Caprile, A., Peters, T., & Melo Almeida, A. L. (2025). Confiscation of immobilised Russian sovereign assets: State of play, arguments and scenarios (PE 775.908). European Parliamentary Research Service. https://www.europarl.europa.eu/RegData/etudes/BRIE/2025/775908/EPRS_BRI%282025%29775908_EN.pdf

- Cardwell, P. J., & Moret, E. (2023). The EU, sanctions and regional leadership. European Security, 32(1), 1–21. https://doi.org/10.1080/09662839.2022.2085997

- Casey, C. A., Rennack, D. E., Fergusson, I. F., & Elsea, J. K. (2024, January 30). The International Emergency Economic Powers Act: Origins, evolution, and use (CRS Report R45618). Congressional Research Service.
- https://www.congress.gov/crs-product/R45618

- Cœuré, B. (2013, September 2). Outright Monetary Transactions, one year on (Speech). European Central Bank. https://www.ecb.europa.eu/press/key/date/2013/html/sp130902.en.html

- Council of the European Union. (n.d., a). *The euro at 25*. https://www.consilium.europa.eu/en/euro-at-25/

- Council of the European Union. (n.d., b). *Timeline – Packages of sanctions against Russia since February 2022*. https://www.consilium.europa.eu/en/policies/sanctions-against-russia/timeline-packages-sanctions-since-february-2022/

- Draghi, M. (2012, July 26). Verbatim of the remarks made by Mario Draghi (Speech at the Global Investment Conference, London). European Central Bank. https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html

- Duisenberg, W. F. (1999, January 14). The euro has arrived. European Central Bank. https://www.ecb.europa.eu/press/key/date/1999/html/sp990114.en.html

- Eurostat. (2025). EU trade with Russia – latest developments. European Commission. https://ec.europa.eu/eurostat/statistics-explained/index.php?title=EU_trade_with_Russia_-_latest_developments

- European Central Bank. (n.d.). Implementation of monetary policy in the euro area. https://www.ecb.europa.eu/mopo/implement/app/html/index.en.html

- European Central Bank. (2025a, June). The international role of the euro. https://www.ecb.europa.eu/pub/pdf/ire/ecb.ire202506.en.pdf

- European Central Bank. (2025b, June 17). Europe's "global euro" moment. ECB Blog. https://www.ecb.europa.eu/press/blog/date/2025/html/ecb.blog20250617~7de14a39c3.en.html

- European Central Bank. (2025c, July 24). What is T2? https://www.ecb.europa.eu/ecb-and-you/explainers/tell-me/html/what-is-t2.en.html

- European Commission. (2026, January 12, a). *The euro outside the euro area*. https://economy-finance.ec.europa.eu/euro/use-euro/euro-outside-euro-area_en

- European Commission. (2026, February 23, b). *Holding Russia accountable*. https://commission.europa.eu/topics/eu-solidarity-ukraine/holding-russia-accountable_en

- European Parliamentary Research Service. (2026). *EU budget 2026: Overview and key issues (PE 785.052)*. European Parliament. https://www.europarl.europa.eu/RegData/etudes/BRIE/2026/785052/BUDG_BRI%282026%29785052_EN.pdf

- Farrell, H., & Newman, A. L. (2019). *Weaponized interdependence: How global economic networks shape state coercion*. International Security, 44(1), 42–79. https://doi.org/10.1162/isec_a_00351

- Hooghe, L., & Marks, G. (2009). A postfunctionalist theory of European integration: From permissive consensus to constraining dissensus. *British Journal of Political Science, 39*(1), 1–23. https://doi.org/10.1017/S0007123408000409

- Juncker, J.-C. (2018, September 12). *State of the Union 2018: The hour of European sovereignty* (Speech). European Commission. https://ec.europa.eu/commission/presscorner/detail/en/speech_18_5808

- Lisdero, G. (2022, October). *The European integration of the Western Balkans and the EU's lack of commitment: The case of the unilateral euroization of Montenegro and Kosovo*. In Proceedings of the International Scientific Conference "Social Changes in the Global World" (Vol. 1, No. 9, pp. 79–87).

- Manzanaro, S. S. (2025, February 27). *EU was formed to 'screw' US, Trump says in promising tariffs on cars*. Euractiv. https://www.euractiv.com/news/eu-was-formed-to-screw-us-trump-says-in-promising-tariffs-on-cars/

- Mathieu, A., & Funalot, P. (2024). *Reverse the road: From European Monetary Union to euroization*. Global Policy, 15(5), 1015–1024. https://doi.org/10.1111/1758-5899.13420

- Moloney, N. (2017). The European Union in international financial governance. RSF: The Russell Sage Foundation Journal of the Social Sciences, 3(1), 138–152. https://doi.org/10.7758/rsf.2017.3.1.08

- Radio Free Europe/Radio Liberty. (2012, June 27). Germany's Merkel says no eurobonds "as long as I live". https://www.rferl.org/a/germany-merkel-says-no-eurobonds/24628220.html

- Reuters. (2012, June 1). Italy's Monti sees eurobonds becoming reality. https://www.reuters.com/article/world/italy-s-monti-sees-eurobonds-becoming-reality-idUSBRE8510EF/

- Reuters. (2025, October 6). EU must follow law in using frozen Russian assets to help Ukraine, Lagarde says. https://www.reuters.com/world/europe/eu-must-follow-law-using-frozen-russian-assets-help-ukraine-lagarde-says-2025-10-06/

- Spielberger, L. (2025). No longer neutral: The ECB's geopoliticization of the international role of the euro. Politics and Governance, 13.

- Verhelst, S. (2013). A beginner's guide to differentiated integration in the EU. Studia Diplomatica, 66(3), 7–18.



About the Article

Asks how the introduction of the digital euro could impact International Relations, through changes in monetary power. The digital euro could strengthen the European Union by increasing monetary sovereignty, reducing reliance on U.S.-based payment systems, and expanding the EU's regulatory influence globally. The paper concludes that the digital euro could enhance the EU's strategic power in global finance, but its success depends on managing risks.

About the Author

Student of International Relations and Organizations at Leiden University in The Hague, with a strong interest in global governance and sustainable development. She actively volunteers with an environmental organization, contributing to initiatives that address climate change and promote community resilience. Her academic and volunteer experiences have shaped her passion for the intersection of environmental policy and economic development. She aspires to pursue a career in economic affairs, focusing on solutions that balance growth with sustainability.

Introduction

The financial sector is undergoing a current wave of digitalization, putting pressure on the evolution and modernization of the international monetary system. Evidence for this is the decrease in cash usage: in 2022, cash accounted for almost 60% of transactions, whereas today that share is 52%, a figure that continues to decline (Balz, 2022, p. 2). In response, central banks have been exploring the development of Central Bank Digital Currencies (CBDCs). However, these extend beyond technological innovations and carry significant geopolitical importance; their introduction could affect payment systems, monetary sovereignty, financial stability, and the balance of power (Westermeier, 2024, pp 1570-1571). A strong case for the urgency of modernization for technological and strategic purposes is the European Union's (EU) proposal for a digital euro, which aims to enhance the Union's competitiveness in the international monetary system, particularly against the dollar and the yuan. Therefore, the introduction of this policy creates the opportunity for the E.U. to consolidate itself as a normative power and to reinforce the monetary sovereignty that they currently lack.

Background: digitalization of finance and the European Central Bank

New technologies have enabled faster transactions, reduced costs, and introduced new forms of economic interaction. In addition, there has been a rise in the number of big tech companies and an increase in the popularity of cryptocurrencies, with almost 600 million users worldwide up until 2025 (Eleshin et al., 2025, p. 1). Nevertheless, these changes have raised questions about the extent to which the state retains control over payment infrastructures and money, as well as how the role of the Central Bank is being challenged (Balz, 2022, p. 2). Thus, digital currencies are being framed as a tool to preserve monetary sovereignty, referring to the control and state authority over their currency and monetary policies (Landau & Nicole, p. 5, 2024)

In definition, CBDCs are the digitalized version of what we know as central bank money, backed by the institution, centralized, and integrated into existing monetary systems (European Central Bank, n.d.). Therefore, it is just an alternative form of payment, not an intended replacement for physical cash. The European Central Bank has explained that through this alternative, the intention is to ensure a risk-free access to money in an era of technological transition and to reduce the dependence on non-European payment providers such as Visa, MasterCard, or PayPal (European Central Bank, n.d.). This reliance is not only an economic concern but also geopolitical, as given that these firms operate under U.S. jurisdiction, they are subject to U.S. regulations and sanctions. This creates a risk for the EU as transactions are regulated by third-party states, and data can be stored, processed, and governed outside the EU.

The EU is not the only power that has proposed a digital currency; multiple others are also in the process of development. China can serve as an example and be considered one of the early movers, as they have already started a trial run of an e-CNY or digital yuan in multiple cities

around the country (Paulovici, 2025, p. 2979). With this move, China could gain structural advantages in payment systems, surpassing other nations that aim to be a normative financial power and dominant in the economic and financial sector.

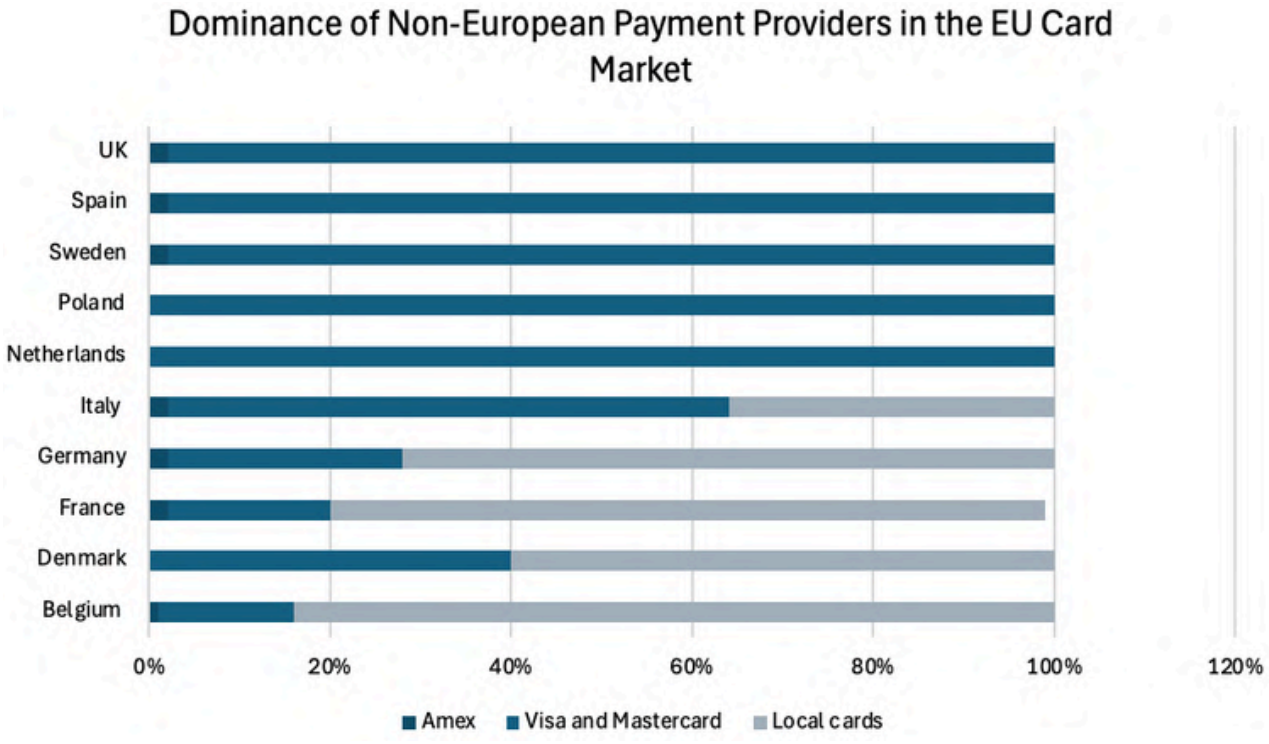
The three motivations behind the digital euro

Digital currencies and more specifically the euro have been driven by a combination of political, economic, and strategic factors. Three categories that highlight the use of technology to increase a country's relative advantages.

Firstly, the EU seeks to achieve monetary sovereignty by reducing its dependence on non-European providers, such as Visa or Mastercard, which combined have a market share of almost 90% (European Court of Auditors, 2025). A greater control over the payments landscape gives

gives the organization better monitoring power over regulatory and data privacy compliance, as well as the opportunity to increase efficiency by unifying the sector and supporting competition and innovation. A digital euro would then increase the strength of the EU's financial infrastructure, one strong enough that it would reduce reliance on external third-party providers (Giovani, 2023, p. 25).

Furthermore, the EU aims to improve its economic position and increase its international relevance. This has increased in urgency as the yuan continues to rise, the dollar continues to be dominant and preserve its position as the reserve currency, and the talks on digital currencies from other emerging economies are starting (Heidebrecht, 2026, p. 3). All these factors that affect the union's foreign policy not only highlight the incentive and priority to modernize but also the direction of the international monetary order, which is opening space for new powers to emerge



Source figure 1: RedCompass Lab

emerge and challenge the long-lasting dominance of the U.S. Thus, to enhance its position and maintain its competitiveness the EU has to be able to offer a credible and trusted digital currency within its regulatory framework.

Finally, while economic and political factors are the main drivers of this policy, there is also a broader strategic aim of the EU to act as a normative force (Heidebrecht, 2026, p. 4). As with the General Data Protection Regulation (GDPR), through the design of a digital currency, the EU can protect its regulatory standards internationally, embedding principles such as privacy protection, consumer rights, and data governance. This process is often referred to as the Brussels effect, whereby the EU unilaterally shapes global regulations and companies adopt them to access the market (Bradford, p. 2, 2020).

Weaponized interdependence: This term refers to states holding key positions in financial networks to exert coercive power or push for change in a certain actor's policy.

Comparative analysis between the digital yuan and the digital euro and its financial implications

The digital yuan and the digital euro are two of the biggest projects that are reshaping monetary and financial infrastructure. While both examples are similar in definition, they differ in their political, ideological, and institutional models of digital finance, hence having different implications for their financial and monetary systems.

On the one hand, China's digital yuan represents a more state-centric and centralized model. The design attributes great control to the government, giving authorities power to monitor transactions, financial data, and overall strengthen control over the financial sector (Paulovici, 2025, p. 2982). Conversely, the EU promotes a rule-based model emphasizing principles of privacy protection and regulatory transparency, limiting the control the state has over financial transactions (pp. 2985-2986). Their design not only shows the role of ideology in policymaking but also exhibits the normative competition between two powers with very different models of digital finance.

Their variations in design make both currencies have different implications at each level. Firstly, in terms of monetary policy, the digital yuan would provide real-time economic data on spending patterns to the People's Bank of China (PBC), allowing faster policy interventions and a more precise monitoring of economic activity (p. 2991). The digital euro, on the other hand, is more cautious, focusing more on preserving the stability of the system. This tool would increase the efficiency of the European Central Bank to influence the velocity of money circulation, interest rates, and money supply. Therefore, its function would be limited to complementing existing monetary tools while simultaneously reinforcing the stability of the system. Another implication concerns Central Banks and the risk that digital currencies could reduce the role of banks as intermediaries in the financial system. This occurs when consumers shift their money from commercial banks into

their digital central bank wallets. To mitigate this risk, China is proposing two solutions: the enforcement of caps, limiting the money a consumer can keep digitally with the central bank, and, secondly, tiered remuneration, which is when different interest rates depend on the balance. Similarly, the ECB also proposed a cap; however, their alternative solution is an indirect insurance model where banks distribute and manage digital euro wallets instead of the ECB dealing with citizens, minimizing systemic constraints. Finally, where both approaches relate the most is in their digital currencies' potential to increase financial inclusivity. Both the yuan and the digital euro would allow underbanked communities to access financial services; however, their target audiences diverge. China is focusing more on rural communities, while the European Union is extending it to all digitally illiterate and all underbanked regions around the Eurozone (p. 2989).

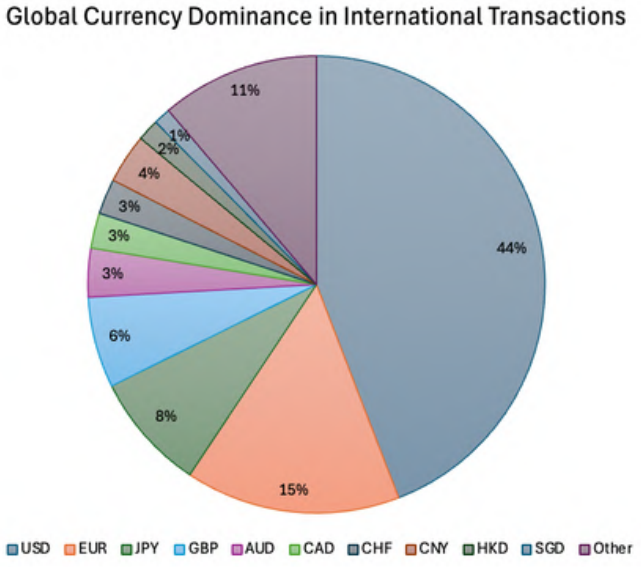
Weaponized interdependence: This term refers to states holding key positions in financial networks to exert coercive power or push for change in a certain actor's policy.

Cross-border payments and international economic relations

International payments today are costly, complex, and slow due to the fragmented structures and multiple intermediaries. The digital euro could help simplify transactions not only within the union but also with external partners and other CBDCs, creating a multilateral payment framework (Demertsiz & Martins, 2023, p. 197).

While initiatives like the SEPA have improved transaction speeds within the EU, cross-border payments remain fragmented and dependent on multiple intermediaries. This inefficiency is largely due to the reliance on banking networks and systems such as SWIFT, which can take up to days and involve fees of around 6-7%. Hence, the unification of the system through a digital euro would increase efficiency by reducing costs, connecting central banks, and enabling the use of local currencies for international transactions (p. 199). For small and medium-sized enterprises, this is particularly beneficial as they are the most affected by high transaction costs in international trade. As a result, this would increase cross-border volumes and improve market access, strengthening economic integration within and outside of the EU.

This is highly significant as the system is overwhelmingly dominated by the dollar, involved in almost 90% of all trades. In this



Source figure 1: RedCompass Lab

context, digital currencies would reduce dependencies on the United States, allowing central banks to reduce the number of transactions in dollars and to trade in their own currencies.

On the other hand, for international relations, this unification would destabilize the current balance of power, reducing the dominance of the United States and its ability to weaponize interdependence. This term refers to states holding key positions in financial networks to exert coercive power or push for change in a certain actor's policy. Meanwhile, for the EU, a widely used digital euro embedded in cross-border settlement platforms would increase its structural power, requiring businesses or third parties seeking investment to comply with European regulations and expectations (Westermeier, 2024, pp. 1580-1583).

Risks and limitations

Despite its benefits for European autonomy and rise as a normative power, the digital euro comes with great risks and constraints. For consumers, the new alternative might not be attractive, so to protect central banks, policymakers have to introduce caps or regulatory restrictions on holdings. This not only makes the digital euro less attractive as a store of value but also highlights how private alternatives might still be more competitive (Gütschow & Lucke, 2025, pp. 9-14). In addition, a complex regulation might also create challenges, complicating the adoption among consumers.

Financial stability is another concern. Some scholars argue that in times of uncertainty, the digital euro facilitates a rapid transfer of deposits from commercial banks into digital euros, creating a higher risk of bank runs and destabilizing the financial system. However, it is important to acknowledge that the introduction of caps or an indirect insurance model would overcome this challenge, measures that the EU is already planning to undertake, as previously mentioned (Esposito, 2022, p. 8).

Finally, cybersecurity plays a major role with big concerns about financial surveillance and data protection among citizens. A digital euro increases the risks of cyber attacks, fraud, and technical failure, weakening trust among users and partners. Ultimately, the effectiveness of the digital euro will depend on the EU's ability to solve these problems, maintaining confidence in the security and governance of the system (Duhnevich, 2025, p. 49).

Policy implications

Overall, while the current world context creates an urgency to modernize and innovate, the design and implementation of these tools will have long-term consequences, which can translate to diplomatic issues or a current power imbalance. Thus, policymakers will need to consider a series of priorities:

1. Balancing openness and sovereignty

Europe needs to reduce its dependence on American corporations and strengthen its financial infrastructure; however, an excess of protectionism can impact the success of its digital euro and international adoption. European policymakers thus need to find a balance between achieving monetary sovereignty and ensuring interoperability with global financial systems.

2. Building and prioritizing strategic partnerships

On the same line, the digital euro creates an opportunity to build on alliances and create new strategic partnerships. The cooperation with other like-minded economies helps set new standards and shared norms on trust, data use, and cybersecurity. An early cooperation and establishment of norms can increase the attractiveness of digital finance among other democracies.

3. Protecting financial stability

While the new version of the euro can increase efficiency, reduce costs, and bring in new consumers, this can also become a threat to financial stability without strong regulation. Hence, the organization will need to either introduce caps on holdings or impose other conditions to prevent massive transfers of money from commercial banks into central banks. These regulations will be key to preventing and maintaining control during economic crises.

4. Leveraging regulatory power

Finally, an early move to digitalize currencies allows the European Union to rise as a normative power. The integration of rules on transparency, data governance, and consumer protection increases the EU's global influence and makes it an important power in the governance of digital finance

References

- Bradford, A. (2020). *The Brussels effect: how the European Union rules the world*. Oxford University Press.
- Balz, B. (2022). The digital euro – an opportunity for Europe [Speech]. CashCon 2022, Leipzig. https://www.bis.org/review/r220907b.pdf
- Demertzis, M., & Martins, C. (2023). Progress with the digital euro. *Intereconomics*, *58*(4), 195-200.
- Duhnevich, O. (2025). Strategic and technological aspects of the digital euro: between regulatory challenges and scientific understanding. *Aspects of public administration*, *13* (2), 40-50. https://doi.org/10.15421/152519
- Eleshin, F., Sun, Q., Ye, M., Das, S., & Hong, J. I. (2025, April). Of secrets and seedphrases: Conceptual misunderstandings and security challenges for seed phrase management among cryptocurrency users. In *Proceedings of the 2025 CHI Conference on Human Factors in Computing Systems* (pp. 1-19). https://dl.acm.org/doi/pdf/10.1145/3706598.3713209
- Esposito, L. (2022). Digital euro issuance: a great opportunity with some risks. *Journal of Payments Strategy & Systems*, *16*(4), 369-380.
- European Central Bank. (n.d.). *What would the digital euro be?* https://www.ecb.europa.eu/euro/digital_euro/html/index.en.html

- European Central Bank. (n.d.). *Why do we need the digital euro?* https://www.ecb.europa.eu/euro/digital_euro/why-we-need-it/html/index.en.html

- European Court of Auditors. (2025). *Digital payments in the EU: Progress towards making them safer, faster, and less expensive, despite remaining gaps.* https://www.eca.europa.eu/ECAPublications/SR-2025-01/SR-2025-01_EN.pdf

- Heidebrecht, S. (2025). How and why EU Institutions Promote the Digital Euro: The Politics of a Central Bank Digital Currency (CBDC). *JCMS: Journal of Common Market Studies*. https://onlinelibrary.wiley.com/doi/pdf/10.1111/jcms.70062

- Landau, J.P. & Nicole, S (2024). Monetary sovereignty in a digital world. SciencesPo: Chair digital, governance, and sovereignty. https://www.sciencespo.fr/public/chaire-numerique/wp-content/uploads/2024/06/DIGITAL-SOVEREIGNTY-policy-brief.pdf

- Paulovici, T. (2025). The Digital Yuan vs. the Digital Euro: Diverging Paths in Central Bank Digital Currency Developments. *Proceedings of the ... International Conference on Business Excellence*, *19*(1), 2978–2992. https://doi.org/10.2478/picbe-2025-0228

- Westermeier, C. (2024). The digital euro: A materialization of (in) security. *Review of international political economy*, *31*(5), 1569-1592. https://doi.org/10.1080/09692290.2024.2345613



About the Article

How do cryptocurrencies affect financial stability and security compared to gold? Both rely on scarcity but differ in relation to state power. Gold is embedded in state systems and supports stability, while cryptocurrencies enable decentralized transfers outside institutions. This weakens sanctions and oversight, increases volatility, and shifts financial authority away from states.

About the Author

Viktoria Royeck holds a bachelor's degree in Economics from the University of Bonn, where she focused on sustainability-related issues. As a scholar of the Konrad Adenauer Foundation, she has developed a strong academic interest in the intersection of politics, international trade, and business, further reinforced by her work as a research assistant and her participation in UN simulations.

1. Introduction

At first glance, gold and cryptocurrencies, most prominently Bitcoin, share a defining economic characteristic: scarcity. Both assets derive value, at least in part, from constrained supply, positioning themselves as alternatives to inflation-prone fiat currencies. However, this apparent similarity obscures a more consequential distinction. The way scarcity is produced, and the extent to which it is embedded in systems of political authority, differ fundamentally, raising important questions for financial stability, regulatory capacity, and international security.

Bitcoin's scarcity is algorithmically fixed and fully transparent. The protocol enforces a hard cap of 21 million units, a limit that cannot be altered without broad consensus across the network. As of early 2026, approximately 19.6 million bitcoins have been mined, representing more than 93 percent of the total supply (Glassnode, 2026; CoinMarketCap, 2026). The remaining issuance follows a predetermined schedule, decreasing through halving events roughly every four years, which reduces the rate of new supply by 50 percent. This implies that more than 99 percent of all bitcoins will be mined by around 2035, with full issuance only reached gradually thereafter (Glassnode, 2026). In this sense, Bitcoin represents a form of scarcity that is not only limited but fully predictable in advance.

Algorithmic scarcity is a supply limit enforced by code rather than physical or economic factors. Unlike gold, whose supply evolves, Bitcoin's supply is fixed and predictable.

Algorithmic Scarcity: Algorithmic scarcity is a supply limit enforced by code rather than physical or economic factors. Unlike gold, whose supply evolves, Bitcoin's supply is fixed and predictable.

Gold, by contrast, is characterized by physical scarcity shaped by geological and economic constraints. Approximately 205,000 metric tons of gold have been extracted throughout human history, with annual production adding around 3,000 to 3,500 metric tons, corresponding to a growth rate of roughly 1.5 to 2 percent (World Gold Council, 2023). Estimates of remaining underground reserves suggest approximately 50,000 metric tons, although these figures are subject to change depending on price developments, technological innovation, and geopolitical access to deposits (United States Geological Survey, 2024). Gold's scarcity is therefore not fixed but evolves in response to economic and political conditions.

This distinction between predictable and contingent scarcity has direct political implications. Scarcity alone does not ensure stability; it must be embedded within institutional frameworks capable of generating trust and enforcing rules. It is precisely here that gold and cryptocurrencies diverge.

Gold remains deeply integrated into the state-centric financial system. Central banks collectively hold more than 35,000 metric tons of gold reserves, including substantial holdings

within the Eurosystem (World Gold Council, 2023). These reserves serve multiple functions: they hedge against currency risk, support confidence in monetary policy, and provide resilience in periods of geopolitical uncertainty. In this context, gold contributes to the stability of existing financial structures and remains embedded in systems of public authority.

Cryptocurrencies, by contrast, operate in a partially deterritorialized financial environment. Bitcoin enables peer-to-peer transactions without reliance on central banks or regulated intermediaries, thereby reducing the effectiveness of traditional oversight mechanisms. While this may increase efficiency and financial accessibility under certain conditions, it also complicates regulatory enforcement, particularly in cross-border contexts (Financial Action Task Force, 2023).

For European policymakers, this divergence raises concrete challenges. The implementation of regulatory frameworks such as MiCA reflects an effort to reassert oversight over digital asset markets within the European Union. However, the decentralized architecture of cryptocurrencies may limit the effectiveness of jurisdiction-based regulation, particularly where transactions occur outside regulated platforms or across fragmented legal regimes (European Central Bank, 2023).

The comparison between gold and cryptocurrencies is not merely economic but concerns the structure of monetary authority itself. Gold reinforces a system in which states and central banks retain a central role in managing trust and stability. Cryptocurrencies, by contrast, introduce parallel mechanisms that may, under certain conditions, operate beyond or alongside these structures. This distinction has direct implications for sanctions enforcement, anti-money laundering frameworks, and the broader capacity of states to govern financial flows in an increasingly digital and transnational environment.

2. Shared Logic: Scarcity

Despite their structural differences, gold and Bitcoin share a core economic logic: both derive value from constrained supply relative to demand. This principle, often described as scarcity-driven valuation, has historically underpinned the role of commodities as stores of value and has been explicitly replicated in the design of cryptocurrencies.

Gold's economic function has long been linked to its relative scarcity. The total above-ground stock of gold grows slowly compared to other commodities, with annual production increasing supply by approximately 1.5 to 2 percent (World Gold Council, 2023). This low and relatively stable growth rate contributes to gold's high stock-to-flow ratio, a key metric used to assess an asset's ability to preserve value over time. Historically, assets with high stock-to-flow ratios, such as gold and silver, have demonstrated resilience against inflationary pressures.

Bitcoin adopts and formalizes this logic in digital form. Its issuance schedule mimics, and in some respects exceeds, the scarcity characteristics of gold. The programmed supply cap of 21 million units and the declining issuance rate create an increasingly constrained flow of new supply relative to existing stock. Following the 2024 halving event, Bitcoin's annual supply growth fell below 1 percent, placing it in a similarly

restrictive supply regime (Glassnode, 2026). This engineered scarcity has contributed to its frequent characterization as "digital gold."

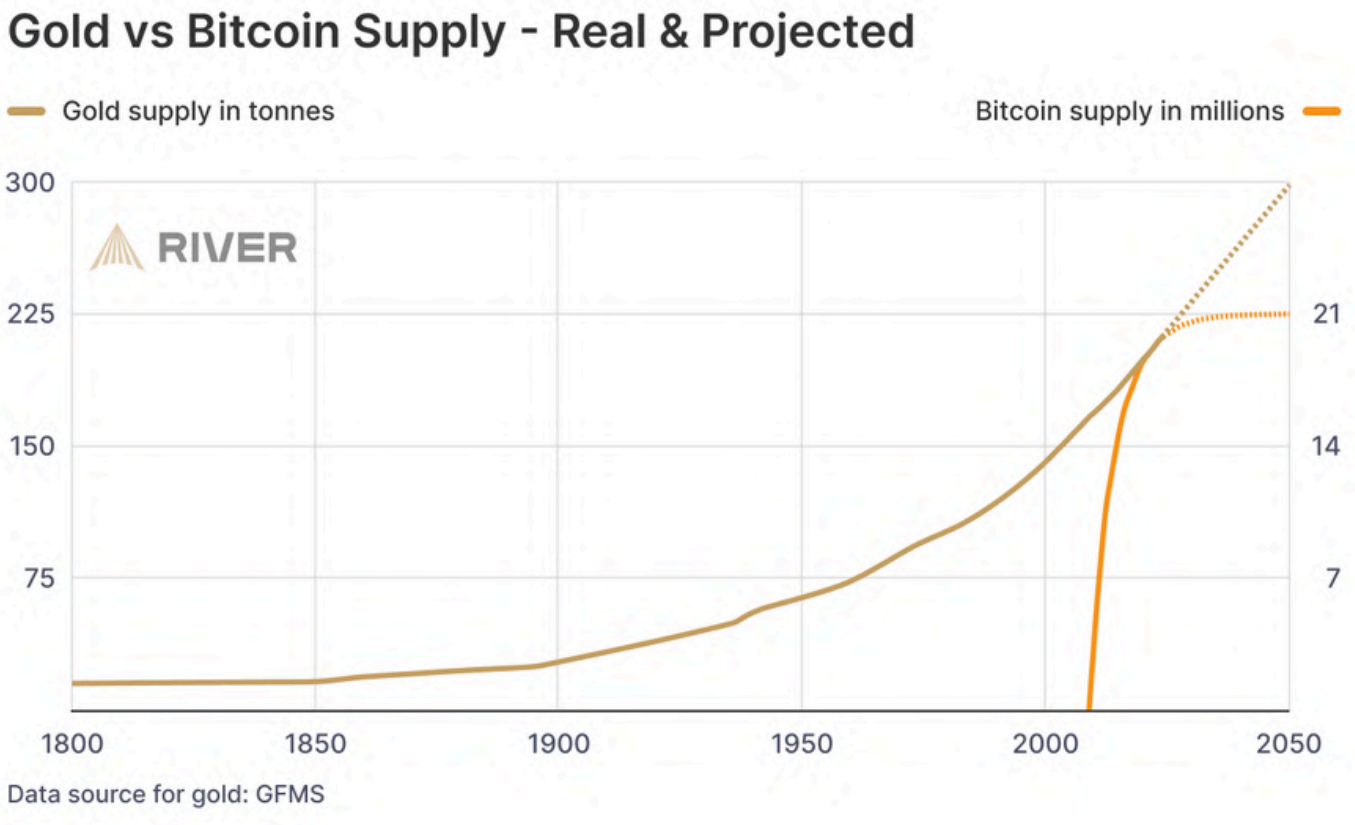
However, the equivalence implied by this comparison remains limited. While both assets rely on scarcity, the mechanisms through which scarcity translates into value differ in practice.

Gold has historically exhibited relatively low volatility and stable demand across economic cycles, whereas Bitcoin's price dynamics remain highly sensitive to speculative flows and macroeconomic conditions (Bank for International Settlements, 2023; International Monetary Fund, 2023). This suggests that scarcity alone does not guarantee the characteristics typically associated with a stable store of value.

3. Divergence: State Power

While gold and Bitcoin share a scarcity-based logic of value, their roles within the international financial system diverge fundamentally due to their relationship to state power and institutional control. This divergence is not merely conceptual; it has direct implications for financial governance, regulatory enforcement, and international security.

Gold is deeply embedded in state-based monetary systems. Central banks remain among the largest holders of gold, collectively controlling more than 35,000 metric tons of reserves (World Gold Council, 2023). Within the European context, institutions such as the European Central Bank and national central banks continue to treat gold as a strategic reserve asset, particularly in periods of monetary uncertainty. In 2022 and 2023, central bank gold purchases reached their highest levels in decades, reflecting increased demand for assets perceived as politically neutral and resilient to financial sanctions (World Gold Council, 2023).



Gold's integration into the international financial system is closely linked to its role in reinforcing state authority. It is held within regulated institutions, accounted for in national balance sheets, and, if necessary, can be mobilized to support currency stability or international payments. Importantly, gold operates within a framework that remains ultimately subject to political control. States can restrict their movement, regulate their trade, or leverage them as part of a broader economic strategy.

Bitcoin, by contrast, operates outside this institutional architecture. Transactions are validated through decentralized consensus mechanisms rather than centralized authorities, and ownership is not inherently tied to identity within a regulated system. This enables cross-border value transfers without reliance on traditional intermediaries such as banks or messaging systems like SWIFT. While this architecture increases efficiency and reduces transaction barriers, it also limits the capacity of states to monitor and control financial flows.

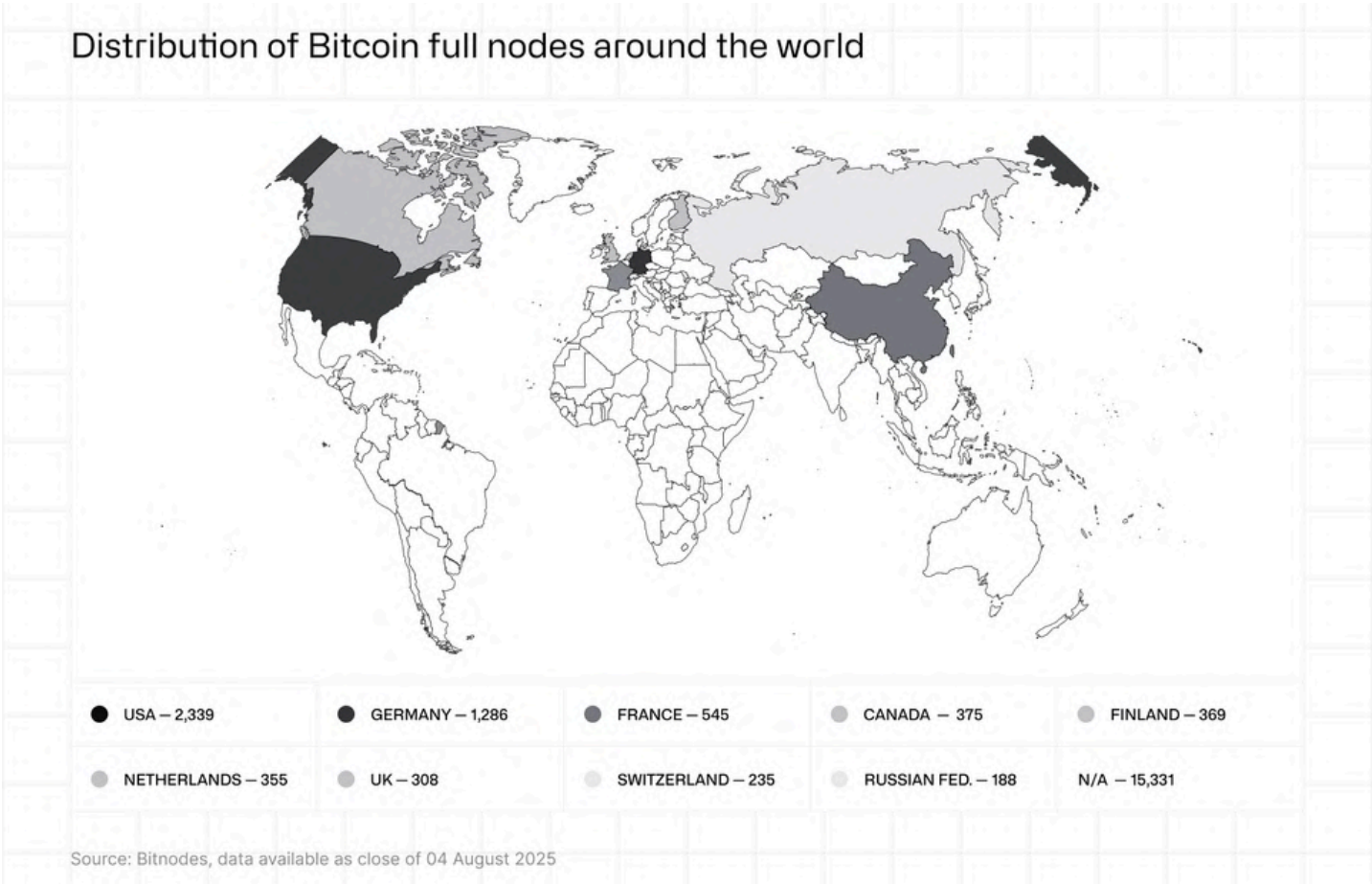
This structural difference has become increasingly relevant in the context of international sanctions and illicit finance. Reports by Chainalysis estimate that illicit cryptocurrency transactions reached tens of billions of US dollars annually in recent years, including ransomware payments, darknet market activity, and sanctions-related transactions (Chainalysis, 2024). Although these flows represent only a small share of total crypto activity, they illustrate how decentralized financial systems can be used to bypass traditional enforcement mechanisms.

The implications are particularly visible in the context of sanctions regimes. Following the imposition of financial sanctions on Russia after the invasion of Ukraine in 2022, policymakers raised concerns about the potential use of cryptocurrencies to circumvent restrictions on cross-border payments and asset transfers. While empirical evidence suggests that large-scale sanctions evasion via cryptocurrencies remains constrained by liquidity and traceability limitations (International Monetary Fund, 2023), smaller-scale transactions and network-based financing mechanisms remain difficult to fully control.

Scarcity alone does not ensure stability; it must be embedded within institutional frameworks capable of generating trust and enforcing rules.

For European policymakers, this creates a structural contradiction between decentralized infrastructure and jurisdiction-based regulation. On the one hand, regulatory frameworks such as MiCA aim to integrate crypto-assets into existing supervisory regimes. On the other hand, the underlying architecture of decentralized networks limits the extent to which control can be fully reasserted. This raises questions about the long-term effectiveness of jurisdiction-based regulation in a financial system where value transfer can occur across borders without centralized intermediaries.

In this context, the contrast between gold and Bitcoin reflects changing patterns of financial control.



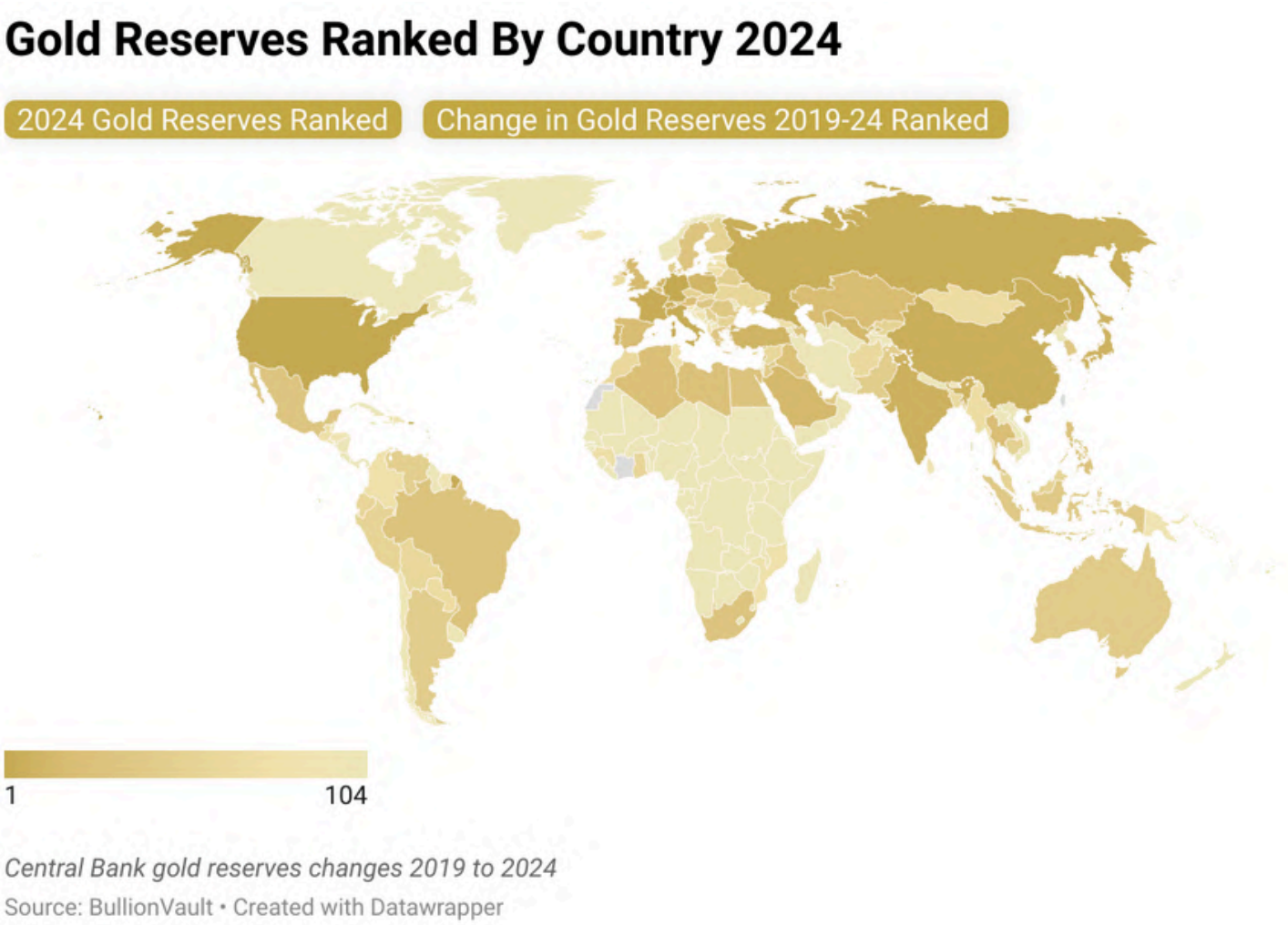
4. Systemic Risk & Security

The divergence between gold and cryptocurrencies is particularly evident in their respective implications for financial stability. While gold has historically functioned as a stabilizing asset during periods of economic stress, cryptocurrency markets have exhibited pronounced volatility and episodic systemic disruptions, raising concerns about spillover risks into the broader financial system.

Empirical data illustrate the scale of this volatility. Bitcoin has experienced multiple boom-and-bust cycles over the past decade, with price declines exceeding 70 percent during major corrections, including the downturns of 2018 and 2022 (Bank for International Settlements, 2023). In contrast, gold prices have historically shown lower volatility and have often increased during periods of market uncertainty, reinforcing their role as a safe-haven asset (International Monetary Fund, 2023).

The events of 2022 provide a particularly instructive case. The collapse of the Terra-Luna ecosystem erased approximately USD 40–60 billion in market value within weeks, triggering a broader loss of confidence across crypto markets. This was followed by the failure of several major crypto firms, including lending platforms and exchanges, culminating in the bankruptcy of FTX, at the time one of the largest global cryptocurrency exchanges. Estimates suggest that total crypto market capitalization declined by more than USD 1 trillion during this period (BIS, 2023; IMF, 2023).

These episodes highlight structural vulnerabilities within the crypto-financial ecosystem. Unlike



traditional financial institutions, many crypto platforms operate with limited regulatory oversight, opaque balance sheets, and significant maturity and liquidity mismatches. The absence of lender-of-last-resort mechanisms further amplifies systemic risk, as liquidity shocks can rapidly translate into insolvency.

From a financial stability perspective, a key question is whether such disruptions remain contained within the crypto sector or pose risks to the broader financial system. To date, spillover effects have been relatively limited, primarily due to the still modest integration of crypto assets into traditional banking and financial markets (Financial Stability Board, 2023). However, this insulation may diminish as institutional exposure increases, including through investment funds, payment systems, and potential links to stablecoin infrastructures.

Stablecoins represent a particularly important transmission channel. Designed to maintain a stable value, often pegged to fiat currencies, they have become a critical component of crypto market infrastructure. Yet their stability depends on the credibility and liquidity of underlying reserves. The collapse of algorithmic stablecoins such as TerraUSD demonstrated how quickly confidence can erode, triggering large-scale withdrawals and market contagion (BIS, 2023).

In contrast, gold does not exhibit comparable systemic risk dynamics. Its market structure is relatively transparent, its supply is not subject to rapid expansion or contraction, and it is not

reliant on leveraged financial intermediaries in the same way as crypto assets. While gold prices fluctuate, these movements rarely generate cascading failures across financial institutions.
For policymakers, cryptocurrencies introduce a distinct category of financial risk, including leverage, liquidity stress, and contagion.

As the scale and integration of crypto markets continue to grow, the likelihood of systemic interactions with traditional finance may increase. This raises important questions for regulators regarding capital requirements, market oversight, and crisis management frameworks, particularly in jurisdictions such as the European Union, where efforts to regulate crypto assets are advancing but remain incomplete.

5. Case Studies

The growing adoption of cryptocurrencies has introduced new challenges for international security, particularly in the areas of illicit finance, sanctions enforcement, and the governance of cross-border financial flows. While illicit activity represents only a small share of total crypto transactions, estimated at less than 1 percent of overall volume, its absolute scale and strategic implications remain significant (Chainalysis, 2024). Illicit cryptocurrency transactions reached approximately USD 20–25 billion annually in recent years, including ransomware payments, darknet market activity, fraud, and sanctions-related transactions (Chainalysis, 2024). The characteristics of these flows, speed, pseudonymity, and global accessibility, create enforcement challenges that differ fundamentally from those in traditional financial systems.

Ransomware provides a particularly illustrative case. The 2021 Colonial Pipeline attack in the United States resulted in a ransom payment of approximately USD 4.4 million in Bitcoin, demonstrating how cryptocurrencies can facilitate attacks on critical infrastructure with direct economic and security consequences. While a portion of the funds was later recovered, the case highlighted both the traceability and the operational challenges associated with enforcement.

State-linked actors have also leveraged cryptocurrency ecosystems. The Lazarus Group, widely associated with North Korea, has been linked to large-scale cyber theft operations involving crypto-assets, with cumulative proceeds estimated in the hundreds of millions to billions of US dollars over multiple incidents (IMF, 2023; FATF, 2023). These activities illustrate how digital assets can be integrated into broader strategies of sanctions evasion and revenue generation.

Following the imposition of sanctions on Russia after its 2022 invasion of Ukraine, policymakers raised concerns about the potential use of cryptocurrencies to bypass financial restrictions. While current evidence suggests that large-scale sanctions evasion remains constrained by liquidity and transparency limitations (International Monetary Fund, 2023), cryptocurrencies may still facilitate smaller-scale transactions and reduce reliance on monitored financial channels.

For European policymakers, this creates a complex risk landscape. Regulatory initiatives such as Markets in Crypto-Assets (MiCA) and strengthened anti-money laundering frameworks represent efforts to extend oversight into digital asset markets. However, the decentralized and

transnational nature of these networks complicates enforcement. Transactions can be routed across multiple jurisdictions and platforms, limiting the effectiveness of traditional regulatory tools.

These cases show that cryptocurrencies are already affecting the practical enforcement of sanctions, AML measures, and critical infrastructure protection.

6. Conclusion

Gold and cryptocurrencies do not just represent different forms of scarcity. They point to different limits of state control. Gold remains tied to institutions that states can use, monitor, and mobilize when needed. Cryptocurrencies do not.

This difference has practical consequences. States can still regulate exchanges and impose rules at the edges, but they cannot fully control systems that are designed to operate without them. That gap matters. It reduces the reach of sanctions, weakens oversight of cross border flows, and makes parts of the financial system harder to govern.

The result is not a sudden loss of control, but a gradual shift. Financial authority becomes less concentrated and more contested. If that trend continues, the main challenge for policymakers will not be how to integrate cryptocurrencies into existing rules, but how to operate in a system where those rules no longer apply everywhere.

References

- World Gold Council (2023). Gold Demand Trends 2023.
- United States Geological Survey (2024). Mineral
- Commodity Summaries: Gold.
- Glassnode (2026). Bitcoin Supply Data.
- CoinMarketCap (2026). Bitcoin Market Data.
- Bank for International Settlements (2023). Crypto Trading and Systemic Risk.
- International Monetary Fund (2023). Global Financial Stability Report.
- Financial Stability Board (2023). Crypto-Asset Regulation Report.
- Chainalysis (2024). Crypto Crime Report.
- Financial Action Task Force (2023). Virtual Assets Risk Assessment.
- European Central Bank (2023). Crypto-Assets and Financial Stability.

EPIS Thinktank

Business Strategy & Corporate Affairs

Put on your Patagonia vest and pack your golf clubs because EPIS is going to launch a business-focused think tank: **Business Strategy & Corporate Affairs (BSCA)**!

With BSCA, we want to focus on economic and business-related issues. We are mostly interested in innovation and companies, and want to find out what it takes to run a successful firm with cutting-edge products.

BSCA

In the initial stage, BSCA will bring you several new formats:

Start-Up of the Month
One start-up each month - get an insight into the workings of up-and-coming firms that strive to enhance our lives

Founders' Report
A deep dive into promising firms across various sectors. We will release three Founders' reports every year, with each featuring 10 companies.

Founders' Podcast
Similar to the Founders' Report, but in a podcast form. Every month, we invite one start-up founder to talk with us about all things business: what is their idea, what makes their company unique, and how they plan to achieve success.

You are interested in working with us?
You know someone who can contribute?
You got experience in audio editing?

Join BSCA!

Join Us

Want to author the next EPIS BSCA Report?

>> Apply for BSCA Now!

APPLY



Message Lucas on WhatsApp.
He will assist you :)

EPIS BSCA Leader
+49 155 6597 5423
bsca[at]epis-thinktank.com

Still got Questions ?



About the Article

Main Question: How can businesses navigate an increasingly fragmented and uncertain geopolitical landscape? Argument: Companies must integrate geopolitical analysis into their core business strategy rather than treating it as an external factor. Conclusion: As global dynamics grow more complex, the demand for experts who can translate political trends into strategic business decisions will continue to rise.

About the Interviewees

Fabian did his Bachelor's and Master's degree in industrial engineering at KIT in Karlsruhe. There, he focused on statistics, econometrics and macroeconomics. He has a profound interest in international relations and economics as well as in tech tech. He pursued an internship in a Tel Aviv tech startup where he was in contact with the DIW.

About the Interviewer

Theodor Himmel connects students with experts in diplomatic and economic affairs. Together with his colleagues, he built EPIS Think Tank into one of the largest student-led think tanks in Europe and also initiated the EPIS Network. He currently serves as Chairman of EPIS. Alongside this, after completing an LL.M. at Leiden University, he is finalizing his legal training as a law clerk at the Regional Court of Baden-Baden. Currently, he works as a consultant in a Munich-based family office.

Himmel:

Mr. Vetter, you work at Agora Strategy, a consulting firm focused on geopolitical and strategic analysis. Could you briefly explain what your role involves?

Vetter:

Yes, of course.

At Agora Strategy, we work at the intersection of geopolitics, economics, and business strategy. Our goal is to help companies understand global developments and translate them into strategic decisions.

My role involves analysing geopolitical trends, identifying risks and opportunities, and supporting clients in adapting their strategies to an increasingly complex international environment. This can include topics such as supply chain disruptions, political instability, regulatory changes, or shifts in global power dynamics.

Geopolitical Analysis: The study of how factors such as geography, economics, and politics influence international relations and the strategic decision-making of states and organizations.

Himmel:

How did you end up working in this field?

Vetter:

It wasn't a completely linear path.

I studied political science and international relations, with a strong focus on global governance and security. During my studies, I developed a strong interest in how political decisions affect economic and business environments.

After that, I gained some experience in policy-related roles, which helped me understand how institutions operate.

At some point, I realised that I wanted to work in a more applied environment, where I could directly connect geopolitical analysis with practical decision-making. That's how I moved into consulting.

Himmel:

What are the main challenges companies face today in terms of geopolitics?

Vetter:

The main challenge is uncertainty. We are moving away from a relatively stable global order towards a more fragmented and contested environment.

Companies are increasingly exposed to geopolitical risks that they cannot control, such as trade tensions, sanctions, or conflicts.

At the same time, they are expected to remain competitive and resilient. This means that businesses need to integrate geopolitical analysis into their core strategy, rather than treating it as something external.

Companies are increasingly exposed to geopolitical risks that they cannot control, such as trade tensions, sanctions, or conflicts, and must integrate geopolitical analysis into their core strategy.

Himmel:

Do companies generally take these risks seriously?

Vetter:

More and more, yes.

In the past, geopolitics was often seen as something distant, mainly relevant for governments.

Today, companies realise that geopolitical developments can have direct and immediate impacts on their operations.

However, many organisations are still in the process of developing the necessary capabilities to deal with these challenges effectively.

Himmel:

What kind of skills are important for someone who wants to work in this field?

Vetter:

First, a strong understanding of international relations and global dynamics is essential.

But that alone is not enough. You also need to be able to translate complex political developments into concrete business implications. Analytical skills are very important, as well as the ability to communicate clearly and concisely.

In addition, it helps to have some understanding of economics and business, because ultimately the goal is to support strategic decision-making.

Himmel:

What advice would you give to students who are interested in this type of career?

Vetter:

I would say that it's important to combine theory with practice.

Academic knowledge is fundamental, but you should also try to gain practical experience through internships, projects, or other activities. It is also useful to develop a broad perspective and stay informed about global developments.

Finally, be open to different career paths. There is not one single way to enter this field.

Himmel:

Do you think that the importance of geopolitics will continue to grow in the future?

Vetter:

Yes, definitely.

Geopolitics will play an increasingly central role in shaping economic and business environments. Companies that can anticipate and adapt to these changes will have a significant advantage.

At the same time, this also means that the demand for expertise in this area will continue to grow.

Himmel:

Perfect, thank you very much.

Agora Strategy
Your Global Compass







About the Article

How can the EU overcome structural vulnerabilities while reforming its slow, politically driven enlargement? The EU must deploy the €30B Industrial Resilience Facility and an EIB-backed 70% political risk insurance mechanism to embed candidates into European energy, technology, and manufacturing value chains. Enlargement must evolve into a mutual security strategy; by tying candidate stability directly to EU economic resilience, Europe builds an "industrial security belt."

About the Author

I went to language camps in Poland several times. I am currently studying to become an international lawyer, and I am writing theses and small studies on this subject. I am most interested in humanitarian law. Also in 2026 won EPIS Policy Competition with 99%

Proposes a fundamental shift in the European Union's enlargement policy, transforming it from a politically driven process supported by financial aid into a strategic instrument for industrial security. The current model of EU enlargement no longer corresponds to the structural challenges facing Europe. While it continues to emphasize political convergence and economic assistance, the EU is simultaneously confronted with far more urgent issues: deep dependency on Asian supply chains, particularly China, a growing shortage of skilled labor due to demographic decline, and increasing vulnerability to geopolitical disruptions. At the same time, candidate countries are still treated primarily as future beneficiaries of cohesion funds rather than as immediate contributors to European industrial resilience. This creates a structural contradiction: the EU urgently needs industrial capacity and workforce, while candidate countries possess both, yet integration remains slow and fragmented. Without a systemic shift, Europe risks maintaining strategic vulnerability in key sectors such as energy, microelectronics, and battery production. The cost of inaction is therefore higher than the cost of integration.

Blended Finance: A mechanism combining public and private capital to reduce risk for private investors and scale up financing for major industrial projects.

At the core of this proposal lies a single central instrument - the EU Industrial Resilience Facility (EIRF) - designed as a financial and operational mechanism to integrate candidate countries directly into EU industrial value chains. With a proposed budget of €30 billion for the period 2027-2034, the Facility would be jointly administered by the European Commission and the European Investment Bank (EIB). Its structure combines three key financial tools: targeted grants for industrial infrastructure, investment guarantees to reduce private sector risk exposure, and blended finance mechanisms that leverage both public and private capital. Unlike traditional funding instruments, the EIRF is conditional: financial support is provided only to projects that are structurally embedded within EU supply chains, comply with European regulatory standards, and involve participation of EU-based industrial actors. This ensures that investments do not remain isolated but become integral components of the European economic system.

A critical barrier to such integration is political risk, which remains the primary deterrent for large-scale industrial relocation. Investors are less concerned with efficiency gaps than with exposure to war-related damage, expropriation, or sudden regulatory changes. To address this, the program introduces a reinforced political risk insurance mechanism administered by the European Investment Bank. This mechanism would cover up to 70% of investment risks, including losses resulting from armed conflict, government expropriation, or regulatory instability. Its funding model combines EU budget resources with private sector contributions, ensuring both credibility and scalability. This instrument is not merely supportive but foundational: without risk guarantees, no serious industrial relocation will take place. By directly mitigating uncertainty, the mechanism unlocks private capital flows into

candidate countries at a scale that traditional aid instruments cannot achieve.

Human capital is treated within this framework not as a social dimension but as a core component of industrial infrastructure. Europe's demographic decline is already constraining economic growth, particularly in technical sectors, while candidate countries possess a young, skilled, and underutilized workforce. To bridge this gap, the program establishes a scalable system of Joint Vocational Degree (JVD) networks. These consist of regional training hubs operating under EU standards and developed in partnership with major industrial actors such as Siemens and Bosch. With a projected capacity of 50,000 students annually, the system is based on a dual education model combining training with direct employment pathways in EIRF-supported industries. Diplomas are automatically recognized across the EU, but the system is designed to anchor employment locally. The underlying principle is clear: talent retention is not a social policy but an industrial necessity. By relocating high-quality jobs rather than labor, the program reverses traditional migration patterns and reduces pressure on EU labor markets.

The EU Industrial Resilience Facility (EIRF) would deploy €30 billion to directly integrate candidate countries into European industrial value chains.

To ensure practical applicability, the proposal is anchored in concrete industrial deployment cases. One example is the development of a battery production cluster in Western Ukraine, integrated into European electric vehicle supply chains and supplying manufacturers in Germany and Central Europe. This project would be supported through a combination of EIRF grants and political risk guarantees, creating a secure environment for industrial investment. Another example is the establishment of a hydrogen corridor between Poland and Ukraine, aimed at developing joint infrastructure for hydrogen transport and storage while supporting the EU's broader green transition strategy. These cases illustrate how candidate countries can function not as peripheral partners but as fully integrated components of European industrial systems.

Energy integration constitutes a further pillar of the program, as industrial expansion cannot occur without stable and affordable energy supply. The initiative therefore envisages the integration of candidate countries into the EU's energy system through joint gas and hydrogen storage facilities, participation in collective energy procurement mechanisms, and targeted investments in renewable energy infrastructure. This approach enhances both flexibility and resilience of the European energy system while ensuring that industrial clusters operate under competitive conditions.

The broader geopolitical outcome of the program is the creation of an "industrial security belt" around the European Union. By embedding candidate countries into critical production and energy networks, the EU establishes a system of positive interdependence in which the stability of these countries becomes directly linked to the economic security of existing member states.

If essential components for European industries are produced in cities such as Kyiv or Chisinau, their stability is no longer a peripheral concern but a core strategic priority. In this model, economic integration effectively precedes political accession, accelerating the enlargement process through material interdependence rather than formal commitments.

Failure to implement such a strategy carries significant risks. Continued reliance on Chinese supply chains leaves the EU exposed to external shocks and political leverage. The absence of structured investment mechanisms increases the likelihood of inefficient or misused reconstruction funding in candidate countries. At the same time, lack of local economic opportunities drives uncontrolled labor migration into the EU, exacerbating social and political tensions. The proposed program directly addresses these risks by replacing passive financial assistance with targeted, conditional, and strategically aligned integration tools.

In conclusion, EU enlargement must evolve from a political promise into a core industrial security strategy. The Mutual Industrial Resilience Program provides a coherent framework to achieve this transformation by combining a central financial instrument, effective risk mitigation, workforce development, and geopolitical alignment. Rather than framing enlargement as a unidirectional process of support, this approach positions it as a mutually beneficial system of integration that strengthens the economic resilience and strategic autonomy of the European Union.

Conclusion

1. Sanctions and other coercive financial instruments should be applied selectively and strategically.
   - There is a risk that for every additional sanction, a greater number of countries will be incentivized to build out parallel payment and financial systems to protect themselves. The overuse of sanctions, risks undermining the institutional credibility the Western financial system and currencies depends upon.
2. Structural reforms are often necessary.
   - In Europe, a genuine Capital Markets Union (proposals for such are already underway) is needed to deepen the Euro's power and investment flows. Digitalisation is also necessary. There is a heavy reliance on American financial infrastructure. These reforms could allow the EURO to gain more global weight globally and be more independent from the United States. The best way to ensure economic stability within the eurozone is for the ECB not to structure its monetary policy too far outward and instead continue to deliver results within its own "territory".
   - In a similar manner, the Yuan's importance can only grow under increased financial markets reform and liberalization, as there are still heavy restrictions in possessing and transacting with CNY.
   - Payment infrastructures are evolving towards greater multipolarity and political sensitivity. There needs to be cooperation to combat systematic fragmentation as it risks increasing transaction costs and decreasing global connectivity, which could hinder overall trade between non-allied countries. Alternative means of payment such as cryptocurrencies or gold should push states to reconfigure their power (regulation, etc..) within decentralized systems.

Today, the global monetary system rests mainly on a singular currency, thanks to the Dollar's credibility, trustworthiness and depth of the financial system underpinning it. However, the global payments system is evolving towards a multipolar system, due to emerging powers and political disputes, such as the Ukraine-Russia conflict. The USD's dominance will not be questioned in the short-term, however, as time passes, the weight of the dollar in global finance could degrade in the coming decades. Some important players such as China are already trying to carve out more space, and other potential rivals may follow - the EU being one.
Gold, despite being a thousand year old commodity that has been cherished by Egypt's pharaohs, is still an important asset to protect a currency's stability. Cryptocurrency, which has had a strong acceptance in the last few years, is not yet playing a crucial role in global finance (with some very niche carveouts).

A currency being simply an intermediary for transactions is still one of the fundamentals of a country's economy. Distortions in it over a long period of time, such as in the case of the Yen in Japan, can harm a country's economic growth potential.

The architecture of global finance is undergoing a slow but structural transformation, and the decisions taken by major powers over the coming decades on sanctions, trade, financial markets, liberalization, digital infrastructure, and monetary coordination will determine whether this transition leads to a more balanced and resilient system, or to one defined by fragmentation and strategic rivalry.

Yours Sincerely,

Donát Oláh
Report Group Leader
International Economic Relations



About the Article

Why does a supply shock impact gas prices? Changes to oil production capabilities affect the oil supply and its prices. A supply shock creates short-term or long-term changes to oil supply and prices that affect consumer spending and activity.

About the Author

I hold a background in International Affairs and International Studies. My studies focused on U.S. Foreign Policy & National Security, and I have covered topics such as U.S. relations with Russia, China, and Mexico. I am interested in pursuing research in biotechnology and other emerging technologies to raise public awareness and promote ethical standards on these topics.

Introduction

Bombs drop. Oil production facilities are destroyed. Maritime vessels halt or divert their voyages away from the precarious and violent situation in the Strait of Hormuz. These are the headlines you read or see in the news about the Middle East. As you head outside, you notice a sudden uptick in fuel prices at your local gas station.

In this month's coverage of EPIS International Economic Relations, we explore the concept of a supply shock, which is the sudden change to the production and availability of goods. A supply shock may produce different outcomes, such as positive, negative, short-term, or long-term effects.

Supply Shock is the sudden change to the production and availability of goods.

Positive Effects

Under favourable circumstances, a supply shock produces positive effects that benefit both producers and consumers. A positive supply shock results from the increased supply of goods due to events such as technological breakthroughs or increased funding that bolsters production. When the supply of goods increases, the price of goods increases. For example, company "A" discovers a massive reserve of undrilled oil. As the company increases its supply of oil, the price of oil decreases to match consumer demand, thus allowing the company to maintain or increase its profits.

Depending on how much a global crisis disrupts productivity, a supply shock may bring short-term or long-term changes to the supply and price of goods.

Negative Effects

Oftentimes, a supply shock produces negative effects that harm consumers more than producers. A negative supply shock results from the decreased supply of goods due to events such as embargoes or damaged production lines. For example, a war damages company "A"'s oil rigs and impacts the company's production of oil. Due to the decreased oil supply, the company raises oil prices to recuperate or maintain its revenue. Consumers suffer from having to pay higher prices for the limited supply of oil.

Short-Term & Long-Term Effects

Depending on how much a global crisis disrupts productivity, a supply shock may bring short-term or long-term changes to the supply and price of goods. The short-term effect of a supply shock indicates a temporary fluctuation of the supply and price of goods. This fluctuation typically lasts for a few years as the supply and price of goods recover from the initial disruption. The long-term effect of a supply shock indicates a lasting, possibly permanent fluctuation of the supply and price of goods. Due to the impactful effects of a long-term supply shock, the supply and price of goods permanently change and cannot return to pre-shock levels.

Supply Shock and the Impact of War

The concept of supply shock theory helps us understand how everyday goods can suddenly shift in availability and price during global economic crises, such as wars that directly affect supply chains and trade routes. A supply shock may positively impact producers and consumers under favourable conditions that boost productivity, while it may negatively impact producers and consumers under unfavourable conditions, such as the sabotage or destruction of production lines. As the war in the Middle East rages on, producers and consumers further await the impacts on global oil and how their lives will be temporarily or permanently impacted by this phenomenon.

Recommended Literature

Ross, S. (2026). Understanding Supply Shocks: Causes, Effects, and Implications. https://www.investopedia.com/ask/answers/041015/why-do-supply-shocks-occur-and-who-do-they-negatively-affect-most.asp.


Donate
About us
Network
Working Groups
Formats
Report Groups
EPIS Thinktank
The Think Tank for Foreign- and Security Policy
episthinktank
EPIS | Diplomatic & Economic Affairs
448 posts
807 followers
67 following
Community
Thinktank, Network & Consultancy for Students
Connect with Experts & Publish your Articles
Based in
Join EPIS Now
www.epis-thinktank.com and 2 more
Follow
Message
Email
Delegations
W.Groups
Basics
Blog
Announcement
EPIS Conference
2025
EPIS Conference
Speaker
Charting the Strategic Autonomy of the EU
An End in Sight?:
WORLD HEALTH

Imprint

Editors: Donat Olah
ViSdP: Theodor Himmel
Publisher: EPIS ThinkTank e.V.
Contact: board.external@epis-thinktank.com
ISSN:

Are you interested in our work?

EPIS is both a network and a think tank in foreign and security policy. The EPIS Network connects students and graduates, supporting their careers. The EPIS Think Tank produces publications in various formats on different regions and topics. Together, they form EPIS—where you can join passively as a network member or actively contribute to publications. Interested? Apply now for an onboarding meeting & follow us on social media!

Find out more on: www.epis-thinktank.de

or visit us on:



The articles and opinions of the authors do not necessarily reflect the views of the EPIS Think Tank e.V. The authors are solely responsible for the academic integrity of their work, including adherence to scholarly standards and proper attribution of sources.

