MILKEN INSTITUTE

review

Riding Argentina’s Inflation Roller Coaster

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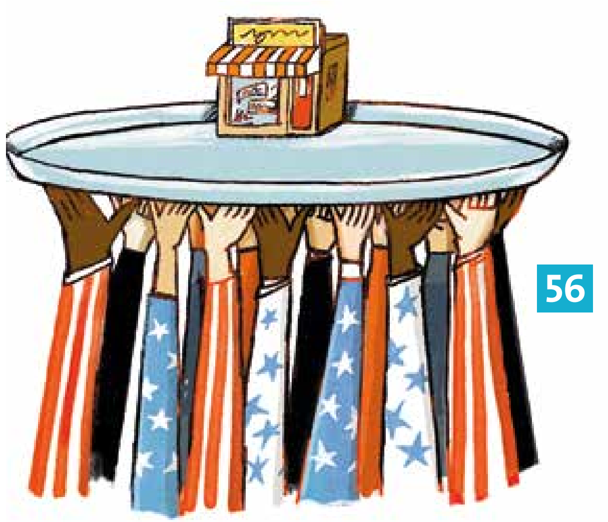
THE MILKEN INSTITUTE REVIEW
THIRD QUARTER 2026



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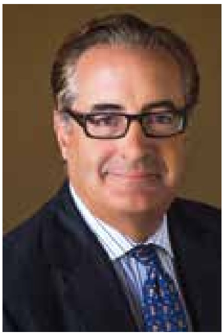
FROM THE PUBLISHER



I treasure my association with the *Milken Institute Review*, but my day (and sometimes night) job is head of the Institute's programming team, the group that coordinates and curates each year's Global Conference. For every "GC," we target the zeitgeist – to provide insight across more than 130 sessions so our 4,000+ attendees can better understand the ideas and currents that shape the time. For our latest conference in May, hitting the zeitgeist was an extremely slippery target. World events changed week by week; many ideas that seemed promising, even inevitable, the preceding December had worn out their welcome by February.

Fortunately, the theme we chose – *Leading in a New Era* – stood us in good stead: recognizing that rapid change in fields ranging from artificial intelligence to geopolitics to global trade have created a shared sense of uncertainty – and paradoxically the certainty that wise leadership is more needed than ever to respond to the challenges.

Unlike a dinner party you missed, the content of Global Conference can still be savored by sampling the session videos posted on the Milken Institute website. Whether your interest is in business, health or philanthropy, or you'd simply like to sample the thinking of key leaders in a host of fields, you'll find something to watch. And for those who may prefer to read than watch, our website provides transcripts.

If not recommendations, I have some personal favorites, including the author talk with Andrew Ross Sorkin on his bestseller *1929*, conducted by David Rubinstein, and my conversation with Arthur C. Brooks on his latest book, *The Meaning of Your Life*. Also of note: the fireside conversation with Venezuelan democratic leader and Nobel Peace Prize recipient Maria Corina Machado on the prospects for democracy in her homeland.

One of the most popular sessions was the conversation with sports icons Shaquille O'Neal and Tom Brady describing their transitions from top athletes to strategic curators of their post-athletic careers. Gratifyingly, Brady led off with these words:

> Conferences like this, and sharing knowledge and shared experience, is what this world's all about. So many people on these panels have so much unique insight into this world, do so many great things in this world. And then you take the things you learn and you take it back to where you live, where you work, the people you hang with, and you spread the knowledge.

Whether you glean ideas from Global Conference, or from articles in this and other issues of the *Review*, we hope you will share them with those you hang with.

Conrad Kiechel, Publisher

This issue, the metaphorical cup runneth over.

ROBERT NEUBECKER

Let the articles speak for themselves.

Karen Dynan, a former assistant secretary of the Treasury, recounts the events that led to the current inflation after decades of price stability. "The price surge does not imply that policymakers were reckless – that a forceful macro response to the Covid-19 crisis was a mistake," she argues. "After what many saw as an insufficient response to the Great Recession, policymakers were determined not to underreact. Moreover, uncertainty about how the pandemic would evolve and about the economy's productive capacity going forward complicated plotting a return to stable growth.

"But the experience of 2021-22 underscores an unwelcome reality: even when inflation has been dormant for decades, it can reemerge if demand is pushed too far, too fast."

Maurice Obstfeld, the former chief economist at the IMF, considers the prospects of Argentina's libertarian president, Javier Milei, in his battle to pull that country out of a century of economic dysfunction. "President Milei is in a relatively strong political position and has accomplished reforms unprecedented in the Argentine context," he writes, "but Argentina's policy framework remains too vulnerable to reversals. Renewed pressure loom in the forms of rising unemployment, lagging government revenue, and persistent corruption.

"With a presidential election due in 18 months, Milei faces a credibility trap. Should the success of his program become widely doubted, his political prospects could deteriorate, making the return of Peronism more likely – a prospect that damages current economic performance and adds to fears of future inflation."

Cliff Winston, a senior fellow at Brookings, tells the story of how the ballooning cost of autos foreshadowed affordability discontent. "True luxury cars were always beyond the reach of the masses," Winston writes. "What's changed is that cheap budget vehicles have been driven to the brink of extinction."

"So many of the problems that seem to contribute to the affordability malaise result from government failure," he adds. "In the auto industry, government failure has allowed automakers to exploit tariffs to the detriment of consumers. The problem could be solved by an administration willing to prioritize consumers over producers, but no administration has yet been willing to step forward."

Bill Frey, a demographer at Brookings, speculates on the societal impact of the Baby Boomers reaching their ninth decade: "This year, America's first boomers – born between 1946 and 1964 – are reaching the age of 80. This giant cohort numbering 79 million at its peak is making a huge, distinct impact on many aspects of the nation's social, cultural and economic life."

"That will certainly include altering senior lifestyles and living facilities," he also points out, "along with raising their voices about the need for better health care. But they also have more in common with today's youth than the seniors they are replacing. They are the most racially diverse older generation to date, as well as the most receptive when it comes to the changing roles of women. We should keep an open mind about the possibility that the former 'don't trust anyone over 30' generation will again draw on its vast experience by building bridges with today's younger generations."

Greg Auclair and **Adnan Mazarei** at the Peterson Institute for International Economics take a long, hard look at President Trump's America First investment gambit with the goal of separating the hype from the substance. "Even if some investments do not materialize," they conclude, "the arrangements still mark a shift in the global investment regime. For decades, the international system rested on the assumption that cross-border capital flows should be driven primarily by commercial considerations mediated by markets. That assumption is weakening."

"Some national security concerns are valid. But the return of industrial policy also raises familiar concerns around inefficiency, favoritism and corruption. At a time when economic governance in the United States is already under strain, the downside risks are significant."

John Austin, a senior fellow with the Eisenhower Institute at Gettysburg College, cuts through the conventional rhetoric to ask what should be done to bolster US manufacturing. "A pragmatic pro-manufacturing, pro-growth agenda needs to be fashioned from elements that have worked very well for America in the past," he writes.

"First, give the private sector the leeway to compete on quality and cost in an increasingly interdependent world – and don't try to put globalization back in the bottle. Meanwhile, accept there is a legitimate (but limited) role for government to promote the national interest through intervention in markets. In particular, government needs to provide "public goods," whose return cannot be fully captured by private actors."

Brian Feinstein, a professor at the Wharton School, challenges the collective wisdom that government initiatives to tilt the playing field in favor of small business makes economic sense. "The costs of this regime are significant and often overlooked," he argues. "Legal preferences for small firms undermine statutory objectives, channel public resources toward less valuable uses, generate unnecessary red tape – and, ironically, undermine firms' incentives to grow to efficient scale. Meanwhile, the usual justifications for these preferences – that they create jobs, spur innovation and counter concentrated political power – are open to serious question."

And look, there's even more! Check out this excerpt from **Eswar Prasad**'s new book, *The Doom Loop: Why the World Economic Order Is Spiraling into Disorder*. The title, alas, says it all.

Happy perusing. *— Peter Passell*

BY CLIFFORD WINSTON

President Trump has frequently dismissed the very idea of an affordability crisis as a political hoax, suggesting the government bears no responsibility for any financial squeeze felt at the kitchen table. But that's not how tens of millions of Americans see it. And while the sources of their frustrations are many and varied, it's clear the chickens are coming home to roost – that is, there has been a substantial decline, especially in the past few decades, in the public's trust of government institutions to improve their lives.

Why is an economy that pumps out more than $85,000 in goods and services per person each year leaving so many dissatisfied? Part of the answer must lie in a phenomenon called premiumization. Across our essential infrastructures, we are seeing a retreat from universal access in favor of high-margin surpluses for the affluent. We see it in the skies, where airlines have squeezed the coach cabin to prioritize business and first-class seating. And we see it on the ground, where in the past half century automobile ownership has morphed from an almost universal symbol of freedom into a budget-buster for the lower 40 percent of households.

PATTI MCCONVILLE/ALAMY

CARS "R" US

The U.S. transportation system has led to most Americans' lives being organized around their private vehicles. In our collective imagination, the car is Steve McQueen's Mustang tearing through the hills of San Francisco or the Beach Boys' "Little Deuce Coupe" brimming with youthful confidence. The way that dependence has played out, however, is sobering. Roughly 85 percent of Americans endure stressful work commutes, often alone, in their cars. And 90 percent are tethered to a steering wheel for essential nonwork trips, such as grocery runs, school pickups or dentist visits. But rising costs of car ownership over the decades have stressed the finances of all but the most affluent among us.

True luxury cars were always beyond the reach of the masses. What's changed is that cheap budget vehicles have been driven to the brink of extinction. From the 1980s through the late 2000s, the budget list includes "econoboxes" like the Toyota Tercel, Geo Metro and Dodge Neon. At a sticker price of $18,000 to $22,000 in today's dollars, they offered low-cost lifelines for commuters. Yet automakers have largely abandoned them because profit margins on small cars were razor-thin and high tariffs have prevented foreign competitors from offering them. Given this protection and the increasing wealth of the top 40 percent of households, automakers have pursued the fat margins of mid-size SUVs and pickup trucks, and prioritized those with the highest margins like the Ford F-Series and Jeep Wagoneer. Those behemoths now command hefty average transaction prices north of $60,000.

Smaller vehicles have been systematically phased out, and with the recent discontinuation of the Nissan Versa and Mitsubishi Mirage, the sub-$20,000 new car has officially vanished from the American market. Even the practical family choices have migrated into luxury-adjacent price brackets: the Toyota RAV4 and Honda CR-V, once the standard for middle-class value, now command average prices near $37,000. Indeed, the shifting composition of the U.S. automobile market pushed the average transaction price for a new vehicle to a record $50,000 in 2025.

To put things in perspective, the $50,000 average transaction price for a new vehicle is nearly a 7.5 percent increase in real terms from 2015, when a new car averaged approximately $46,500 in today's dollars. Even the used car market, the traditional escape hatch for the middle class, is evaporating as a source of economy vehicles, with average used car prices hovering near $27,000 – a price point that a decade ago would have bought a new sedan with all the bells and whistles. This price creep has fundamentally decoupled car ownership from the average American's earnings.

Many households must make do by financing their purchases with six- and seven-year instead of three- and four-year auto loans. The catch? The intersection of soaring vehicle prices and extended loan terms has heightened the risk of repossession for American households – an extreme outcome of the modern automobile affordability crisis. Repossessions doubled between 2020 and 2025; they are projected to surpass 3 million by the end of 2026, echoing the peak of the Great Recession.

The human toll of this pricing surge is reflected in a fleet of zombie cars – vehicles kept on the road long past their safe reliability because their owners are priced out of the replacement market. In early 2026, the average age of a passenger car in the U.S. hit a record 14.1 years, a sharp climb from the nine-year average seen at the turn of the millennium.

For middle-income households, this aging fleet isn't a choice, it's a trap. It creates a massive, hidden welfare loss: by pricing people out of the new market, we are stalling the diffusion of safety and emissions technology and keeping high-emission, less-safe clunkers on the road, negating the very environmental and safety goals the government should support.

To add to the problem, auto repair costs jumped 15 percent in the last year alone, driven by the complexity of modern drive trains, labor shortages and reduced access to

CLIFF WINSTON, a nonresident senior fellow at the Brookings Institution, is the author of *Market Corrections Not Government Interventions: A Path to Improve the U.S. Economy*. This article expands on his essay published in *The New York Times*.

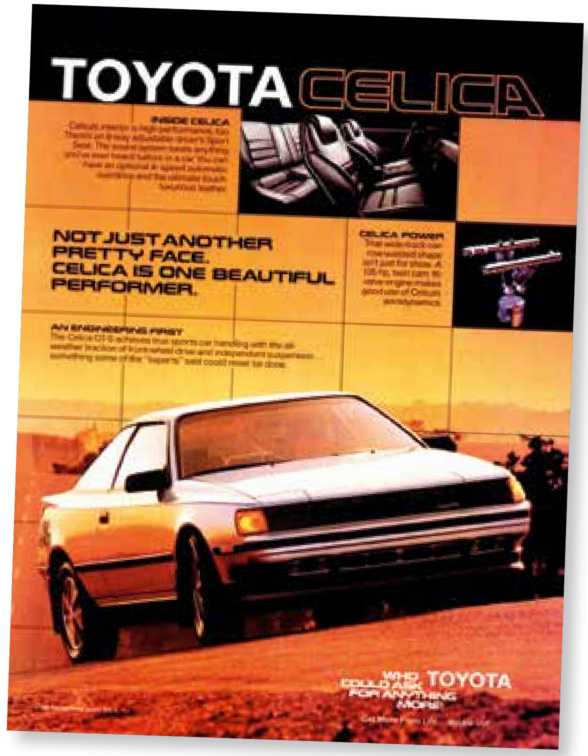
foreign-made replacement parts. An average trip to the mechanic now costs over $840. That's an amount that 40 percent of Americans cannot cover without going into debt, causing owners of clunkers everywhere to pray the "check engine" light doesn't start flashing.

The dearth of affordable, reliable transportation is fracturing the American family's daily rhythm. For one thing, many households are forced to share a single vehicle among multiple working adults. This creates a mobility ceiling: when a car breaks down or is needed by a spouse for the late-night shift, the other family members miss work, kids miss school and medical appointments are skipped. In car-dependent America, an unaffordable car isn't just a financial burden, it is a barrier to basic participation in the economy.

NO EXIT

Urban planners have long advocated public transit as an alternative – it's an important option in Europe and Asia, why not here? The short answer is that it is an attractive, albeit highly subsidized, option for only a small minority of travelers. Car dependence is effectively a fait accompli because U.S. cities lack adequate density to support efficient and extensive route systems that could appeal to commuters and, in any case, cities' current finances have made it much more difficult for them to bear the increasing cost of building and subsidizing mass transit. That's why any sensible urban transportation policy focuses on congestion pricing to make the most efficient use of the nation's existing road capacity.

In any event, there are good reasons to make the most of the reality that, for the foreseeable future, we will live in a non-autonomous, car-dependent economy and culture. Autonomous vehicles will be a game changer, but one that is decades away. Of course, people still derive immense value from the mobility and privacy that private transportation brings. Importantly, car use can expand a worker's relevant labor market by an order of magnitude, improving job matching and quality and driving up both productivity and lifetime earnings. By the same token, the automobile can serve as a critical bridge to the essential infrastructure of a healthy life, easing access to better sources of fresh food, better education and better health care.



PATTI MCCONVILLE/ALAMY

All of this suggests to me that the escalating cost of car ownership, which threatens access to the large benefits from car use, adds more stress on family budgets than its weight on cost-of-living indexes would suggest. But what could – and should – be done about it?

DC KNOWS BEST?

First, it's important to acknowledge that the escalation in car prices is not a natural market outcome like, say, the falling cost of consumer electronics or the rising cost of coffee. Government policies have inflated prices primarily by shielding automakers from competition from foreign automakers.

The initial problematic intervention of the post-war era in the automobile market, a 25 percent tariff on light trucks and cargo vans, was oddly dubbed the Chicken Tax. Imposed in 1964 by President Lyndon Johnson as retaliation against European duties on American poultry, it long outlasted the chicken brouhaha. Indeed, it morphed into a permanent protectionist shield designed to safeguard domestic automakers' profits and United Auto Workers' jobs from a rising tide of imports.

Detroit's insulation from competition bred a lack of quality. U.S. automakers allowed the reliability of their fleets to fall noticeably behind their Japanese rivals.

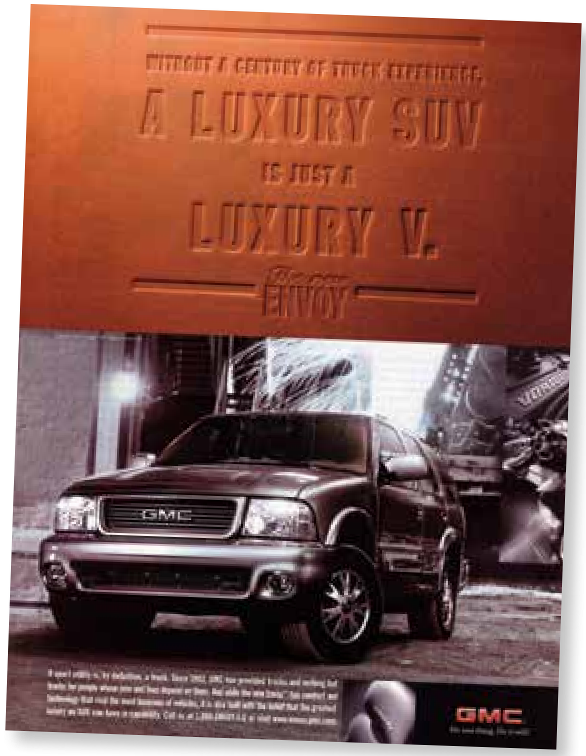
The intent was straightforward: by blocking Americans from accessing low-cost workhorses available from Japan (as well as Europe), such as the Toyota Hilux, the federal government gave American automakers a virtual lock on the light truck market. Hardly anybody remembers why light trucks were singled out in 1964. But the zombie truck tariff marches on, raising prices to consumers while Detroit benefits. When the Chicken Tax was introduced, the market share of light trucks was below 20 percent. Today, light trucks, including pickups, SUVs and vans, dominate the American market, where they are more likely to be found in a suburban valet line than on a muddy road.

By the time the 1980s rolled around, Detroit faced the triple whammy of high gas prices, a demand-killing recession and a murderers' row of Asian competitors making small, fuel-efficient cars that the Big Three couldn't match. Again, Detroit turned to Washington for succor, this time in the form of the 1981 Voluntary Export Restraints forced on Japan by the Reagan administration. Tokyo agreed to cap exports at 1.68 million vehicles per year, effectively creating a shortage of lower-cost, fuel-efficient econoboxes.

Everybody benefited from the Washington-managed cartel arrangement: Detroit got both breathing room to design competitive vehicles and to increase sales in the small car market (with distinctly inferior products) in the meantime, while Japanese automakers got to raise prices. Did I say everybody? Amend that to everybody but consumers, who paid too much and/or got too little for their money.

The VERs ended in 1994, but the legacy of market distortions lives on. Japanese carmakers gradually shifted their focus to more expensive, higher-end products and never looked back, ensuring that every limited slot in their shipment was occupied by a high-margin model. This pivot led to new brands like Lexus (Toyota), Acura (Honda) and Infiniti (Nissan) being launched in the late 1980s. Meanwhile, Detroit utilized its breathing room not to build better cars and regain market share but to raise prices – while government insulated the industry from disaster at the direct expense of the American middle class.

To make matters worse, Detroit's insulation from competition bred a lack of quality. Protected from the pressures of the open market, U.S. automakers allowed the reliability of their fleets to fall noticeably behind their Japanese rivals. The tide only began to turn for consumers when Japanese manufacturers, seeking to bypass the VERs, began building "transplant factories" in the American South and Midwest. Those domestic-built imports gave consumers an escape hatch from subpar American engineering. Even Lee



PATTI MCCONVILLE/ALAMY

Iacocca, the legendary chairman of Chrysler, later admitted the industry's failure with blunt candor: Maybe we sold consumers "some crap," he reflected, noting that customers were now rightfully replacing those inferior vehicles with better-built Japanese cars. In 1989, the Toyota Camry and the Honda Accord became the bestselling cars in the United States.

Over the next decade, trade protection evolved into a durable bipartisan consensus. Even during the open trade era of NAFTA – initially proposed by Ronald Reagan, negotiated by George H. W. Bush, and pushed through by Bill Clinton – the U.S. maintained a 2.5 percent tariff on all imported passenger cars from outside North America. The barrier wasn't high compared to the impact of the VERs, but its durability in the face of the winds of globalization was a clear signal that regardless of the party in power, Washington would never let the American auto market be fully exposed to competition from Europe or Asia.

While trade policies were inflating vehicle prices at the border, domestic regulatory shifts were adding to the pain. Corporate Average Fuel Economy (known as CAFE) standards, introduced in the 1970s, were amended in the 1990s to include a light truck loophole that applied much more lenient fuel efficiency mandates to trucks and SUVs than to passenger cars.

This carve-out was originally intended to spare farmers, small business owners and tradespeople who required trucks with larger engines. However, by classifying SUVs as light trucks for purposes of fuel efficiency (but not for tariffs!) even when they were used primarily as family transport, Washington gave Detroit yet another reason to shift production away from fuel-efficient sedans and toward high-margin "work" vehicles gussied up to carry Cinderella and her prince to balls. This regulatory shield helped to protect Detroit's most profitable segment from nimble foreign competition, incentivizing automakers to pour their R&D into massive Chevy Suburbans and Ford Expeditions rather than the budget-friendly econoboxes that were once the hallmark of middle-class mobility.

For the next two decades, the Bush and Obama administrations largely maintained the status quo for the auto industry. However, trade tensions fed by the rise of the Great Chinese Export Machine finally snapped during President Donald Trump's first term, when his administration utilized Section 232 of the Trade Expansion Act to declare that foreign-made cars and parts were a threat to national security.

The feather-light rationale was that a shrinking domestic auto industry would eventually lack the research, development and manufacturing capacity necessary to support military requirements during a conflict.

Trump subsequently imposed a 25 percent tariff on $250 billion worth of Chinese goods, including auto components and electric vehicles, effectively starting a trade war.

Rather than reversing those policies, President Joe Biden doubled down on them. His administration not only maintained the Trump-era tariffs but expanded them. He

Aided by protectionism, automakers essentially performed an act of demographic triage. They realized that a single $80,000 Ford Expedition generated significantly more profit than four $20,000 Fiestas.

walled off the U.S. market from low-cost competition, most notably by imposing a 100 percent tariff on Chinese electric vehicles. While these measures were designed to protect American jobs and foster a domestic EV supply chain, they have also functioned as a price floor – keeping the affordable $15,000 Chinese EVs that are currently gliding silently through the streets of Paris and Shanghai from ever reaching American showrooms.

Finally, in his second term, President Trump implemented a sweeping 25 percent tariff on imported automobiles and parts – a policy that has added an estimated $6,000 to the sticker price of even the most affordable vehicle segments. Trump again invoked Section 232 of the Trade Expansion Act, arguing that a stagnant domestic production base and a large trade deficit in auto parts somehow threatened the U.S. defense industrial base. Trump also maintained the 100 percent tariff on Chinese electric vehicles.

In sum, the policy initiated by the 1964 Chicken Tax on light trucks has evolved into a broader pattern of protectionist measures for the U.S. auto industry. Each administration has offered its own rationale, but all rest on the misguided belief that legacy manufacturing must be shielded from competition at any cost.

By the time the pandemic hit, the auto industry had already spent a decade preparing to kill the econobox and cut the bottom out of the market. By 2025, households earning over $150,000 accounted for 43 percent of all new car purchases, up from 33 percent in 2019. Meanwhile, the share of new cars bought by those earning under $75,000 dropped from 37 percent to just 26 percent.

Aided by protectionism, automakers essentially performed an act of demographic triage. They realized that a single $80,000 Ford Expedition generated significantly more profit than four $20,000 Fiestas. They didn't need the average American to buy a car anymore; they only needed affluent households to buy a second full-sized SUV.

UNTANGLING

The path to dismantling this slow-motion crisis in affordable transportation is clear, albeit unlikely to be taken by those who today have the power to take it. First, Washington must stop using trade policy to transfer wealth from drivers to manufacturers. Eliminating tariffs on light trucks and automobiles and – most importantly – lifting the embargo on China's affordable EVs would invite the competition necessary to significantly lower prices. One need only look to Canada's recent pivot away from EV protectionism by slashing its prohibitive tariffs on Chinese EVs to a mere 6.1 percent to see how quickly inefficient trade policy can be dismantled to the consumer's benefit. Canada will welcome models like the BYD Dolphin and the Wuling Mini, which may retail for under $20,000.

The argument against opening trade in Chinese vehicles has no more substance than the argument for barring TVs or furniture made in China. Chinese EVs, from brands like BYD, Xiaomi and Zeekr, are highly refined machines that often exceed the digital integration and battery efficiency of American rivals. In many global markets, it is the Chinese manufacturers who are setting the benchmark for cabin quality and safety, leaving Western legacy brands scrambling to catch up.

Concerns about Chinese government subsidies and U.S. job displacement are valid, but they ignore the potential for a new era of transplant manufacturing, especially as the Detroit Three take multibillion-dollar write-downs and retreat from their EV goals and, as in the case of the Chevrolet Trax, transplant in reverse by using high-quality low-cost foreign manufacturing to subsidize their American brand identity. A realistic compromise would be to allow Chinese automakers to sell their EVs in the United States, provided they are manufactured in the U.S., their costs aren't subsidized by the Chinese government, and Chinese automakers satisfy U.S. government security concerns with regard to digital communications.

Surprisingly, the administration may be listening. President Trump has indicated he might be open to transplant factories, suggesting that if Chinese automakers are willing to build factories on American soil and hire American workers, the gates could open. But then again this is Trump, so there is reason to doubt that he will prioritize consumers' preferences for affordable transport over the industry's desire for a shielded market.

While protectionist trade policies have been the primary cause of the automobile affordability crisis, inefficient fuel economy standards and mandated safety regulations, neither of which are based on rigorous cost-benefit analysis, also have increased vehicle prices. Those policies should be discarded in favor of a composite vehicle-miles traveled tax that incorporates emissions and safety components. Such a system would paradoxically have a better chance of reducing emissions and climate externalities and improving safety because consumers would be less likely to stick with older cars. But that's another story.

* * *

Affordability as a political rallying cry that cuts across ideological lines is not likely to go away anytime soon. Economic growth, once seen as the all-purpose elixir to soothe social discontent, has lost its magic, in large part because the rising tide of the stock and home equity markets has lifted less than half of all the boats.

So many of the problems that seem to contribute to the affordability malaise result from government failure – think of land-use restrictions that make housing more costly, regulatory inefficiencies that bloat the cost of health care and pharmaceuticals, weak antitrust enforcement that has allowed the legal profession to be a self-regulated monopoly that serves a very small share of the public, and a government-run education system that costs ever more and delivers ever less certainty in the eventuality of high-paying jobs.

In the auto industry, government failure has allowed automakers to exploit tariffs to the detriment of consumers. The problem could be solved by an administration willing to prioritize consumer welfare over producer protection, but no administration has yet been willing to step forward. That fact may someday encourage an innovative administration to act. At the very least, it should surface in someone's candidacy in the upcoming campaigns.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Lessons from Covid Inflation

BY KAREN DYNAN

Inflation in the United States surged to levels not seen in four decades during the economic recovery from Covid-19. Headlines emphasized the role of supply disruptions – broken supply chains, semiconductor shortages and the energy shock following Russia's invasion of Ukraine. And a close look confirms those factors did, indeed, contribute to higher inflation. But they were only part of the story. Sharply strengthening demand for goods and services was supported by unusually vigorous fiscal policy, and the economy revved to a point where supply simply couldn't keep up. The result was a broad-based rise in prices that extended well beyond a handful of high-profile disrupted sectors. ¶ This surge does not imply that policymakers were reckless – that a forceful macro response to the Covid-19 crisis was a mistake. After what many saw as an insufficient response to the Great Recession, which contributed to a slow, painful recovery post-2008 in terms of both jobs and output, policymakers were determined not to underreact again. Moreover, uncertainty about how the pandemic would evolve and about the economy's productive capacity going forward complicated plotting a return to stable growth.

But the experience of 2021-22 underscores an unwelcome reality: even when inflation has been dormant for decades, it can reemerge if demand is pushed too far, too fast. The challenge now is not to abstain from vigorous stabilization efforts in future downturns, but to design them more carefully.

NOT A SINGLE STORY

The inflation surge of 2021-22, it's worth noting, was not uniquely American. Inflation picked up sharply across almost all countries as the global economy struggled to reopen after the Covid-19 shock. The EU, the UK and Canada (among others) experienced price jolts of a magnitude they had not seen in decades. And the rapid loss of stable prices surprised nearly everyone – including many experts – coming after a long period of low inflation across most advanced economies.

The global nature of the surge reflects, in part, a set of common forces at work. The pandemic was, of course, experienced worldwide, and most governments intervened to stabilize incomes and prevent financial collapse. Then, as economies reopened, global supply chains came under strain, reflecting earlier production shutdowns and transportation bottlenecks. On top of this, Russia's invasion of Ukraine in February 2022 triggered sharp increases in both energy and food prices.

But the fact that inflation was global does not mean it was the same everywhere. The timing and composition of price increases differed across countries, reflecting differences in exposure to energy price volatility, differences in labor market institutions that influenced the impact on employment and worker income and, of course, differences in fiscal responses.

In Europe, energy played an especially central role. The cutoff of Russian gas left households and businesses exposed to sharply higher electricity and heating costs. At first, inflation built more slowly in Europe than in the U.S., but it peaked higher.

Other differences included how much fiscal support individual countries provided, how quickly it was delivered, and how directly it flowed to households. In the United States, fiscal stimulus in 2020 and 2021 amounted to an astonishing 23 percent of pre-pandemic GDP – more than double the scale of the response to the 2008-9 financial crisis and substantially more than in most other advanced economies.

Much of that support was delivered rapidly. In 2020 it did not translate into spending to the extent it normally would have as opportunities to consume (particularly services) were limited by social distancing. But as the pandemic abated, that pent-up purchasing power was released and, supercharged by another substantial shot of fiscal stimulus in early 2021, contributed to a strong surge in demand.

Understanding these differences explains why it matters how central banks respond to instability. The trade-offs are more difficult when inflation reflects an adverse supply shock: belt-tightening may reduce inflation pressures, but can also exacerbate the direct harm to output and employment. Moreover, supply shocks are often temporary, and there may be a case for allowing price jolts to dissipate on their own rather than responding aggressively with tighter money. By contrast, when inflation reflects demand running ahead of the economy's capacity to produce, the policy prescription is more straightforward: restraining demand with tighter credit brings it back into line with supply, helping to

KAREN DYNAN, a former assistant secretary of the U.S. Treasury, is a professor of economics at Harvard and senior fellow at the Peterson Institute for International Economics.

PREVIOUS PAGES: JUSTIN SULLIVAN/GETTY IMAGES

SCOTT OLSON/GETTY IMAGES

cool an overheated economy.

The global backdrop provides important context. It reminds us that policymakers were responding to extraordinary circumstances shared across countries. But it also underscores that the drivers of inflation differed across economies.

For the United States, that distinction is central. To see this clearly, look at how the U.S. episode unfolded – and, in particular, at the impact of an unusually strong jolt of demand on an economy whose capacity to expand output was more limited than many assumed.

WHEN DEMAND OVERWHELMS SUPPLY

Congress, the White House and the Fed had responded forcefully to the crisis in 2020, protecting incomes, helping to stabilize financial markets, and largely reversing the steep drop in employment early in the pandemic. By early 2021, vaccines were rolling out, restrictions on social contact were easing, and households were sitting on unusually large savings built up during 2020.

The recovery from the Covid-induced recession was well underway in early 2021 and widely expected to continue. Indeed, in February, the Congressional Budget Office projected that GDP would continue to close the gap between output and its pre-pandemic trend even in the absence of additional fiscal stimulus.

Now, a central goal of the U.S. fiscal response to Covid was to stabilize demand and avoid a repeat of the snail's-pace recovery from the Great Recession. But policy choices in early 2021 pushed fiscal support much further. In March 2021, Congress enacted the $1.9 trillion American Rescue Plan, a stimulus equivalent to roughly 8 percent of GDP.

Forecasters responded by marking up their projections of GDP growth and marking down their projections of unemployment. But they made only modest upward revisions to their inflation forecasts, expecting inflation to exceed the target a bit in the near term but to settle back to close to 2 percent thereafter. With inflation having run below target for years, and with lingering slack in some measures of the labor market, many analysts believed that supply would expand smoothly to accommodate stronger demand. In hindsight, that confidence in supply flexibility appears misplaced.

When demand is pushed high enough, it can collide with the economy's capacity to produce, leading to broad-based increases in prices even in the absence of large, discrete supply disruptions.

In the U.S., the mix of supporting policies put in place during 2020 along with the fiscal stimulus added in early 2021 pushed demand beyond what the economy could readily produce in the near term. Note, moreover, that the stimulus enacted in 2021 was large compared to contemporaneous estimates of the remaining shortfall in output relative to pre-pandemic expectations. It was larger still compared to what the economy could realistically produce in an environment bent out of shape by the pandemic, with ongoing social distancing among virus-vulnerable workers and their families still placing constraints on labor supply.

The timing and breadth of the inflation surge are consistent with that interpretation. Inflation began to rise in the spring of 2021 not long after the additional fiscal support was enacted and accelerated over the course of that year. Price increases were not confined to a narrow set of pandemic-affected goods. "Core inflation," which excludes volatile food and energy prices to better capture underlying trends, picked up quickly by mid-2021 and moved well above pre-pandemic expectations soon thereafter.

Around the same time, wage pressures began to build, particularly in sectors facing strong demand, suggesting that firms were encountering increasing difficulty expanding production without raising wages. Taken together, these patterns point to economy-wide pressures driving inflation rather than to a small number of isolated disruptions as the culprit.

The distinction between supply shocks and demand-based overheating is central to understanding the episode. Some increases in prices did reflect supply shocks – idiosyncratic events that disrupted the availability of particular goods or inputs. These disruptions were often highly visible and therefore received considerable attention, leading observers to place more weight on their role in explaining the overall inflation surge.

But with hindsight, it's clear that a different mechanism was also at work. When demand is pushed high enough, it can collide with the economy's capacity to produce, leading to broad-based increases in prices even in the absence of large, discrete supply disruptions. The U.S. experience in 2021 fits that pattern more closely than a story centered on a series of independent supply shocks.

Look more closely at the supply bottlenecks widely covered in the news at the time. Shipping delays, port congestion and reports of shortages were often cited as evidence that supply disruptions were the primary driver of price increases. But these indicators are difficult to interpret on their own. In many cases, they simply reflected exceptionally strong demand since the flow of goods to consumers increased substantially during this period even as distribution infrastructure was buckling under strain. In that sense bottlenecks were less a sign of collapsing supply than of demand colliding with a system operating at its limits.

Note, too, that the timing of some of the most widely cited supply shocks is not consistent with them being primary drivers of the inflation surge in the United States. The jolt in global energy and food prices following Russia's invasion of Ukraine did not occur until early 2022, well after inflation in the U.S. had picked up.

Clouding the picture a bit, there were renewed shutdowns in spring 2022 in parts of China – most notably in major manufacturing and port hubs – caused by fears of the Omicron variant of the virus, disrupting the flow of Chinese goods to global markets. Yet while these developments likely contributed to keeping inflation elevated, they cannot explain its onset or its early diffusion across product markets.

Cross-country comparisons provide a complementary perspective. Many advanced economies did experience supply disruptions during this period. But the U.S. delivered fiscal support that was larger, faster, and more directly channeled to households than in most peer countries. By no coincidence, inflation also picked up earlier in the U.S. and appears to have become broad-based more quickly than in Europe. While differences in energy exposure and other factors clearly mattered, the timing is consistent with the view that demand in the U.S. played a dominant role in the inflation surge.

To be clear, supply shocks did play a large, highly visible role in the U.S. But they took place in an environment in which demand had been pushed to unusually high levels. The inflation surge is thus best understood as the result of strong demand bouncing against aggregate economic capacity.

WHAT BLURRED JUDGMENT?

With hindsight, the potential for large-scale fiscal stimulus to generate a surge in demand that would ignite inflation is pretty clear. At the time, though, that risk was harder to assess, and the signals that demand might be pushed beyond the economy's capacity were not widely recognized.

When the American Rescue Plan was enacted in March 2021 the economy was already recovering rapidly, but it was far from evident that the recovery would be sustained. New variants of the virus posed potential risks to reopening. Vaccines had begun to be available, but there was considerable uncertainty about how quickly they would be distributed, how widely they would be accepted, and how effective they would prove against emerging strains.

At the same time, the labor market still appeared to have notable slack. Unemployment had fallen sharply from its pandemic peak of nearly 15 percent, but at just over 6 percent in early 2021 it remained well above most estimates of long-run full employment. Labor force participation – the percentage of adults capable of working who had or wanted jobs – had recovered only modestly from its sharp decline at the onset of the pandemic, suggesting that many would-be workers were still on the sidelines.

The past behavior of inflation reinforced the perception that risks were tilted toward insufficient demand rather than overheating.

MARIO TAMA/GETTY IMAGES

Inflation had remained close to the Fed's 2 percent target for decades and had undershot that target for much of the period following the global financial crisis. Core inflation fell even further below target in the early months of the pandemic. In that environment, many economists were focused on the possibility of chronically weak demand – often framed as "secular stagnation" in which slow economic growth becomes the norm. Against that backdrop, the risk of a sustained surge in inflation appeared remote.

The memory of the global financial crisis and the Great Recession that followed reinforced the inclination to focus more on risks to employment than on inflation. The fiscal support put in place to promote recovery in 2009 was widely viewed as too little, too late. The recovery was slow, and labor market weakness proved persistent. Long-term unemployment rose to unusually high levels, and many discouraged workers left the labor force even as conditions gradually improved.

These labor market effects compounded the financial strain on households following the financial meltdown. It was not until the "hot" labor market of the late 2010s that the finances of many households in the lower part of the income distribution began to recover. Even then, the episode left a lasting imprint at the macro level, with aggregate output growth settling onto a persistently lower path than had been expected prior to the financial crisis.

It should be no surprise, then, that by 2020 and the pandemic, many leaders had come to believe that policy should err on the side of forceful intervention when confronted with severe downturns. In that environment, the risk of doing too little loomed larger than the risk of doing too much. Not surprisingly, policymakers were inclined to accept the possibility of overshooting rather than risk another prolonged period of weak demand and elevated unemployment.

In any event, the nonpartisan Congressional Budget Office, the Fed and private forecasters generally expected that additional fiscal support would accelerate the recovery without tipping the economy into persistently high inflation. And while inflation did pick up over the summer and into the fall of 2021, forecasts were revised upward only gradually through 2021 and into early 2022, even as prices repeatedly surprised on the upside.

These misjudgments in large part reflected the limits of the tools available to forecasters. The point at which an economy will overheat is difficult to gauge even in normal times, and the pandemic made that task far more challenging. While it was widely understood that social distancing and other pandemic-related disruptions were holding back production and limiting the availability of labor, a plausible case could be made that those effects would soon ease as vaccines became widely available and concerns about the virus diminished.

More broadly, economic forecasts rely heavily on statistical models based on historical relationships. In recent decades, those relationships had been shaped by a period of low and stable inflation. As a result, many models implicitly assumed that inflation would respond only modestly to changes in economic slack and were poorly equipped to predict the impact on inflation if the economy approached its capacity limits.

At the same time, the most relied upon indicator of economic slack – the unemployment rate – did not provide a clear signal that the economy was overheating. Although it had fallen significantly from its pandemic peak, it was still somewhat elevated by historical standards in early 2021.

Other labor market indicators pointed in a different direction. Job openings began to rise sharply in early 2021, and the rate of quitting old jobs for new ones rose rapidly as workers took advantage of abundant opportunities for better pay. By the end of the year, both measures had moved well beyond the range seen in the strong labor markets of the late 2010s. In hindsight, these indicators suggest that the labor market was tighter than implied by the jobless rate, but they were not central to how slack was typically assessed at the time.

THE IMPORTANCE OF THE MONETARY PIVOT

Monetary policy played a central role both in supporting the recovery from the pandemic and in bringing inflation back down. The Fed's actions evolved significantly over the course of the episode, reflecting both the difficulty of diagnosing the inflation surge in real time and the importance of responding decisively once its persistence became clear.

At the onset of the pandemic, the Fed deployed both conventional and unconventional tools to stabilize financial markets and support the economy. Interest rates were cut to near-zero, direct purchases of bonds by the Fed were expanded to ease credit scarcity, and emergency lending facilities were introduced. These actions helped restore market functioning and helped to reassure firms that demand would be vigorous once the economy reopened, preventing even greater job losses and positioning the economy for a faster recovery.

The Fed did not begin raising interest rates until March 2022, by which time headline inflation had ballooned to around 7 percent, its highest level in decades. For much of 2021, Fed Chair Jerome Powell was among those characterizing inflation pressures as likely to prove "transitory." Monetary policy remained highly accommodative. Indeed, in December 2021 the most common expectation of Federal Open Market Committee participants – the committee that votes on Fed policy – was that the key interest rate they controlled would remain below 1 percent over the following year.

As Powell himself later acknowledged, the Federal Reserve underestimated both the persistence and the breadth of the inflationary pressures building and was slow to tighten policy as price pressures broadened. But upon realizing a change was needed, the Fed did act decisively.

Beginning in March 2022, the Fed raised its policy rate rapidly and substantially, moving from near-zero to levels not seen in more than a decade. Asset purchases, which loosen business access to borrowed funds, were wound down, and the Fed's formal forward guidance shifted from accommodation to restraint. The central bank thus signaled clearly that restoring price stability was its priority, even at the risk of some job loss.

That pivot mattered. Inflation peaked in mid-2022 and then declined steadily over the following year and a half. By late 2023, overall PCE inflation – the price statistic that tracks more narrowly defined consumer goods and services inflation – had fallen below 3 percent, and core inflation (excluding food and energy) followed shortly thereafter. Although inflation has not fully returned to the target rate in the U.S., it has come down substantially without the recession that many observers had feared would follow from monetary tightening.

This relatively painless disinflation reflects multiple factors. Pandemic-era emergency fiscal support faded. Supply chains normalized. Commodity prices retreated from their peaks. But conventional monetary tightening also played a key role. By cooling interest-sensitive sectors and reinforcing the Fed's commitment to price stability, tighter policy helped slow demand growth and bring it into line with supply.

A crucial additional factor in this success was the credibility that the Fed had built up over decades of keeping inflation low and stable. A central concern during any inflation surge is that expectations of stable prices will come unmoored. If households and firms come to believe that higher inflation will persist, those beliefs can feed back into wage-setting and price-setting behavior, making inflation a self-fulfilling prophecy. The experience of the 1970s remains a cautionary example of how difficult it can be to bring down inflation expectations once they drift upward.

During the Covid-era episode, however, most measures of longer-term inflation expectations remained solid. Survey-based measures did not exhibit the kind of sustained rise seen in earlier high-inflation eras. Likewise, financial market indicators suggested that investors continued to expect inflation to return to target.

That credibility gave the central bank room to act and made its actions more effective. When the Fed signaled a firm commitment to restoring price stability, households and businesses had reason to believe it would follow through. As a result, bringing down inflation did not require the deep and prolonged contraction that dogged earlier episodes.

This inflation episode therefore highlights a powerful lesson. Monetary policy was not omnipotent: it could not instantly offset powerful fiscal impulses or global supply disturbances. Nor was it flawless: the inflation surge

JEFFREY GREENBERG/UNIVERSAL IMAGES GROUP VIA GETTY IMAGES

exposed the difficulty of forecasting in an environment of unique shocks. But the Fed's willingness to pivot forcefully combined with the hard-won credibility of its inflation policy played a central role in preventing the surge from becoming entrenched.

That credibility, however, cannot be taken for granted. Inflation expectations are shaped not only by institutions but by lived experience. The Covid-era surge reminded households and businesses that high inflation can happen here. If repeated inflation shocks occur, or if the public begins to doubt policymakers' resolve, the anchor could come loose. Keeping that anchor in place remains essential – not only for managing inflation today but for ensuring that future stabilization efforts are not undermined by diminished trust.

Moreover, the task is not yet complete. Although inflation has come down substantially from its peak, it has remained above the Fed's target with core measures running above 2 percent in 2025 and vulnerable to renewed pressures in 2026 from the economic shocks linked to the Iran war. Declaring victory prematurely would risk undermining the Fed's hard-won credibility.

GETTING THE BALANCE RIGHT

The inflation surge of 2021-22 was costly in many dimensions. Even as the labor market remained strong, consumer confidence deteriorated sharply as prices rose. Surveys showed that households reacted intensely to increases in food and gasoline prices. These reactions were not simply a matter of perception. On average, wages did increase briskly over this period. But the millions of households whose earnings lagged did see a decline in their purchasing power. Rent increases were particularly pronounced. More generally, heightened uncertainty about the future path of prices made it more difficult for households to plan and manage their finances.

The public reaction to high inflation matters. Inflation does not simply erode purchasing power, it erodes trust. It redistributes income in ways that are often poorly understood and fuels distrust of government and business. Indeed, this episode underscores the reality that inflation can impose significant economic and political costs even when the labor market remains strong.

The U.S. experience illustrates how quickly the economy can move into an overheated state, where additional demand translates more into higher prices than into higher output. At the same time, it would be a mistake to draw the conclusion that policymakers should avoid vigorous stimulation in future economic downturns.

The lessons of the Great Recession remain valid: feeble countermeasures can leave lasting economic scars. Long spells of unemployment reduce cultural pressures to remain in the labor force, weaken wage growth and depress long-term potential output. The forceful economic policy response to the Covid-19 pandemic helped prevent a financial meltdown, stabilized household incomes and supported a remarkably rapid labor market recovery.

In the end, the U.S. economic recovery from the Covid-19 recession outpaced that of many other advanced economies, in part reflecting the scale and speed of policy support. Those achievements should not be discounted. The danger now is overcorrection. If policymakers conclude that aggressive stabilization is inherently reckless, they may hesitate in the next crisis.

The more constructive takeaway is that policy design matters. When uncertainty about economic slack and supply capacity is high, discretionary fiscal interventions are prone to miss the mark.

Strengthening "automatic stabilizers" and rules-based mechanisms could reduce that risk. For example, policies that automatically expand support when unemployment rises and phase it out automatically as labor markets tighten would allow fiscal policy to respond forcefully while limiting the likelihood of overshooting.

Similarly, maintaining a clear and credible monetary framework remains essential. The Fed's ability to pivot decisively, together with the credibility it had earned, helped prevent the inflation surge from morphing into chronic inflation. Preserving that credibility is very valuable, giving policymakers room to act aggressively in crises (and making the occasional error in the process) without immediately unmooring expectations.

Finally, the Covid-19 inflation episode and its aftermath underscore the importance of vigilance. Inflation had been quiescent for decades, and that long period of stability has dulled sensitivity to the risk that high inflation could reemerge. But macroeconomic trade-offs do not disappear simply because they have been absent from recent experience. When demand is boosted rapidly in an economy operating near capacity, price pressures can build very quickly.

The next downturn will doubtless not look like the last. The shocks – and the constraints – will differ. But the tension between speed, scale and calibration of the response will remain. The goal should not be timidity, but discipline – forceful action when needed, molded around institutional guardrails that reduce the risk of painful overshooting and preserve the hard-won credibility that makes stabilization effective.

TK TOMAS CUESTA/GETTY IMAGES

Breaking the Peronist Spell

BY MAURICE OBSTFELD

ARGENTINA

Comprising just 7 percent of Latin America's population and 10 percent of its GDP, Argentina was not top of mind for global affairs analysts until September, when U.S. Treasury Secretary Scott Bessent pledged to do "whatever it takes" to support its embattled currency and its libertarian president, Javier Milei.

In contrast, Argentina had undeniably been top of mind for the International Monetary Fund for decades, and intensely so since 2018.

In July of that year, the fund lent $50 billion to Argentina under a program negotiated with then-President Mauricio Macri. The loan was the IMF's biggest ever to a single borrower, even before being augmented by a further $7 billion as Macri's difficulties quickly worsened. Argentina borrowed billions more from the fund in 2022 to help pay back its earlier loan, and a further $20 billion in a new program under the Milei administration in April 2025. When Bessent announced his intervention late in 2025, Argentina still owed the IMF $57 billion, more than a third of the multinational crisis lender's total outstanding loans.

Bessent's intervention was not motivated by concern for the IMF's balance sheet. He chose instead to label Argentina a "systemically important U.S. ally in Latin America." But that description seemed implausible in historical context – say, when compared with the truly systemic Mexican currency crisis of 1994-95, which also elicited a massive U.S. rescue.

Mexico's 1994-95 crisis sent shockwaves throughout Latin America and threatened broader economic stability in the Americas. For one thing, the Clinton administration feared migrants would flee north in the wake of the economic calamity. For another, the North American Free Trade Agreement had launched only a year earlier – and Mexico accounted for a large share of U.S. goods exports, 9.92 percent in 1994 against Argentina's 0.44 percent of U.S. goods exports in 2024. In 1994, Mexico generated about 30 percent of Latin America's dollar GDP and comprised 19 percent of its population.

But Bessent's understanding of "systemic" flowed from ideology, not economics. In his telling, Argentina under Milei was a "beacon" to draw other Latin American countries away from left-leaning leaders. The second Trump administration's new National Security Strategy soon revealed that Argentina was only the spear-tip of a wide-ranging plan to establish U.S. commercial and military dominance in the Western Hemisphere while rooting out Chinese influence and narcotraffickers.

President Trump meddled in Honduras's presidential election later in 2025. The Venezuelan takeover came early in 2026, followed by joint military operations in Ecuador, increased economic pressure on Cuba, and a new "Shield of the Americas" summit with the Trump administration's "strongest like-minded allies" in Latin America (and therefore excluding the leaders of Brazil, Colombia, Mexico and Peru, which together comprise about 65 percent of the region's population). Several South American countries, including Argentina, have engaged with the United States' efforts to reshape supply chains for critical minerals.

A big question for Milei is whether he can harness the U.S. government's new focus on Latin America to achieve his own ends. His-

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AFP VIA GETTY IMAGES

torically, relations between the two countries have been tortuous, with long periods of mutual frustration or indifference punctuated by briefer periods of rapprochement (at least at the level of ruling elites). Now, Milei is hugging Trump tightly, hoping U.S. support will be the magic ingredient that helps him produce macroeconomic stability and growth where other Argentine leaders failed.

Trump has telegraphed, however, that ongoing U.S. support is contingent on Milei's political success. Milei's re-election bid looms in October 2027, and the economy's performance in the coming months will no doubt be the dominating factor in the outcome.

While Milei has been remarkably successful in reducing inflation and restoring overall growth, many Argentines still suffer economically, unemployment has risen and the government remains reluctant to issue bonds in global capital markets to cover its big bills to foreign creditors. Worse, Argentina's monetary policy framework may not be up to these challenges, and any economic instability could be magnified if Milei falters and Trump decides he needs a steadier "beacon."

THE ARGENTINE ECONOMIC PUZZLE

Until recently, Argentina has flown below the radar of the American public apart from cameo appearances like the hit musical *Evita*, Jacobo Timerman's searing account of human rights abuses under military rule, the Falklands War, and the football exploits of Maradona and Messi. But it has been a perennial object of fascination for economists.

With abundant resources and a highly literate population, Argentina has vast economic potential that never seems to translate into sustained advancement, with hopeful stretches of growth collapsing into crisis and high (even hyper) inflation. That potential was evident in the late 19th and early 20th centuries as the country's bountiful exports of beef, wheat, corn and wool on occasion gave it a spot on the list of the 10 richest countries in the world, measured by real per capita income. Yet after World War I, Argentina fell behind and has never durably recovered.

Argentina's singularity stands out especially clearly when it is compared with other economies that received waves of European immigration in the century before World War I. In research that was awarded the 2024 Nobel Prize, Daron Acemoglu, Simon Johnson and James Robinson observed that countries with high rates of European settler mortality due to malaria and other tropical diseases tended to become extractive colonies where oppressive governing institutional structures took root and persisted, at the cost of later economic growth. In contrast, the large flows of European migrants to more temperate regions – the United States, Australia, Canada and New Zealand – brought along institutions that protected individual property rights, promoting investments and market development supportive of long-term growth.

But despite being a temperate country also settled mostly by Europeans, Argentina has lagged far behind the other "regions of recent settlement." Even largely tropical Brazil, with its legacy of plantation slavery, is no longer far behind Argentina. These facts encapsulate the Argentine puzzle.

WORLD'S 10 RICHEST COUNTRIES IN 1896

COUNTRY	PER CAPITA GDP*
1. United Kingdom	$7,211
2. United States	$6,886
3. New Zealand	$6,357
4. Switzerland	$5,967
5. Australia	$5,874
6. **Argentina**	**$5,716**
7. Belgium	$5,660
8. Netherlands	$5,359
9. Denmark	$4,521
10. Germany	$4,368

* 2011 international dollars

SOURCE: Maddison Project Database (MPD) 2023, https://www.rug.nl/ggdc/historicaldevelopment/maddison/

THE BLAINE DOCTRINE

Trump's 2025 U.S. National Security Strategy proclaims, "We will assert and enforce a 'Trump Corollary' to the Monroe Doctrine" in the Western Hemisphere. However, the true precursor of Trump's approach is not Monroe but James G. Blaine of Maine, a speaker of the House, senator and Republican presidential nominee who also served as secretary of state under three presidents in the late 1800s.

While Trump often speaks fondly of another 19th-century leader, President William McKinley, it was Blaine who authored a strategy toward U.S.-Latin American relations that is startlingly similar to Trump's. Obsessed with countering British influence in the Western Hemisphere and less of a dogmatic protectionist than most other Republicans at the time, Blaine tried to use trade to draw Latin America economically and strategically closer to the United States while promoting U.S. exports. He called the process "annexation of trade," not of territory.

As historian Marc-William Palen recounts:

> The 1890 McKinley Tariff… was authored by… [then] Ohio Congressman William McKinley and Secretary of State James G. Blaine of Maine. The tariff allowed the United States to expand its informal empire through its protectionist reciprocity provision….
> This meant that the 1890 tariff allowed for the signing of a series of bilateral reciprocity treaties, mostly in undeveloped regions of Latin America, so as to expand U.S. market access

> while also curtailing the ability of signatories to sign similar treaties with the American empire's European rivals.

Blaine also sponsored the Pan-American conferences (the first one taking place in 1889) with a grand hemispheric customs union among its goals. The trade project failed. But the Pan-American conferences continued periodically over the years, with the ninth (in Bogotá in 1948) creating the world's oldest regional organization, the Organization of American States. Now Trump wishes to sidestep the OAS with his narrower Shield of the Americas.

Blaine especially resented British dominion over Canada, which he sought to make the 45th U.S. state. The McKinley Tariff included punishing duties on Canada and omitted the opportunities to negotiate bilateral exemptions that were available to some Latin American countries. As in recent experience, the tariffs only enraged the Canadians. Rather than joining the United States to escape them, Canada retaliated harshly and diverted its trade toward Britain.

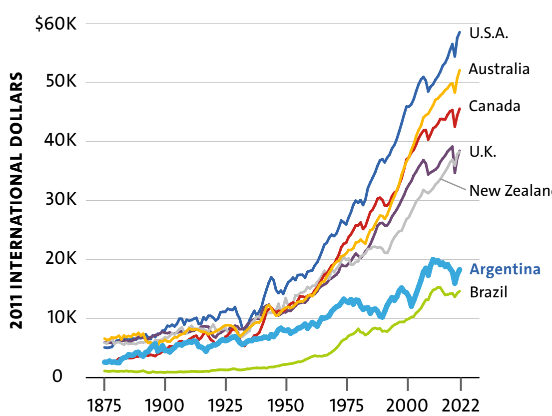
Two of Argentina's biggest exports, beef and wool, were excluded from bilateral arrangements that might spare them from the McKinley tariff. But Argentina had other reasons to resist the U.S. ambitions in Latin America. Carlos Díaz-Alejandro, one of the pre-eminent economic historians of Argentina until his untimely death in 1985, explained how Argentina opposed U.S. regional policies and aligned itself with Britain, its major creditor:

> At least since the first Pan-American conference in 1889, Argentine foreign policy had clashed with that of the United States.… Argentina came to view herself as the other major power in the Western Hemisphere, one whose strong economic and cultural links to Europe and whose desire for an independent stand in international affairs, made her skeptical of U.S.-sponsored Panamericanism. During the early decades of this "American Century" both Right and Left in Argentina criticized United States intervention in the Caribbean and Central America. … In spite of her close economic ties with the United Kingdom, Argentina remained strictly neutral during the First World War, and voiced opposition to the harsh terms imposed on Germany by the Treaty of Versailles. Argentina became an active and respected member of the League of Nations, adopting what today would be called a "non-aligned" stance.

INTERWAR TURBULENCE AND PERONISM

Despite Argentina's adoption of strategic independence in the 1920s, the U.S. became its biggest source of foreign finance and manufactured imports like automobiles and farm equipment, though Britain remained the prime destination for its exports. When the Great Depression arrived, U.S. financial flows dried up as the United States, Britain and other countries restricted access to Latin American exporters. Less able to sell abroad or to secure foreign financing, Argentina had little choice but to expand its domestic industrial base and produce more of what it had

PER CAPITA REAL INCOME



SOURCE: Maddison Project Database (MPD) 2023, https://www.rug.nl/ggdc/historicaldevelopment/maddison/

imported, drawing labor from the countryside into the major cities.

World War II accelerated this process. Argentina found it hard to obtain imports during the war due to shortages and disrupted shipping. Moreover, Argentina's neutrality in the conflict and its continuing dealings with German businesses further alienated Allied countries.

Argentina did finally declare war on the Axis, but barely in time to be made a founding member of the United Nations. And its postwar relations with the United States remained troubled into the 1950s. In an apparent attempt to undermine Juan D. Perón, who was elected to Argentina's presidency in 1946, Marshall Plan administrators went so far as to forbid aid recipients from using the funds to buy Argentine products.

Perón came to power on the back of a growing urban, working-class constituency, offering populist promises to further industrialization and to assert a bigger government role in management of the economy. In particular, Peronism included redistribution of income away from traditional land-owning elites and toward workers (through higher wages and social benefits) along with creating a Peronist elite of functionaries extracting economic rents through an elaborate state patronage system. Industrialization meant import substitution supported by industrial tariffs, government-directed credit and controls over foreign exchange transactions.

The Peronist policy mix, coupled with a government budget deficit that had to be financed by printing money, touched off the inflationary process that characterized Argentina in the decades after. It morphed into hyperinflation around 1990 before being contained for about a decade (see the figure on page 29), which plots the *monthly* inflation

CRISTINA SILLE/PICTURE ALLIANCE VIA GETTY IMAGES rates corresponding to year-over-year inflation rates.

There is no one-line answer to the puzzle of how Argentina fell from its high-income status before World War I. But any explanation for its poor postwar performance must include the tenacious hold of Peronism, which itself has deep social causes. In most incarnations – under Perón himself (1943-55 and 1973-74), his third wife Isabel (1974-76), Néstor and Cristina Kirchner (2003-15) and Milei's immediate predecessor, Alberto Fernández (2019-23) – Peronism led to macroeconomic instability and pervasive clientelism and corruption, which in turn have underpinned the movement's strikingly durable political base. But Peronism as a political movement could on rare occasions depart from Peronist populist economic policies.

Carlos Menem (served 1989-99) was the exceptional Peronist president: his neoliberal policies, a radical break from the past, produced the decade of price stability until a chaotic financial collapse in late 2001 that ultimately brought the Kirchners to power. Several factions now inhabit the large Peronist tent, drawn together when political power is at stake by a populist orientation and partisan identity, along with their shared commitment to state power.

As president, Perón not only imposed a populist agenda, he channeled longstanding Argentine resentments against the United States. His antagonistic stance toward the UN, which he viewed as a tool of U.S. imperialism, included a refusal to join the IMF. In September 1955, worsening economic conditions, along with Perón's battles with the Catholic Church and his personal deterioration after the premature death of his wife Eva in 1952, inspired a military coup.

Exactly one year later, Argentina finally joined the IMF. And in December 1958, the government agreed to an IMF-supported loan and stabilization program – the first in a series of 23 that culminated in the April 2025 IMF loan to the Milei government.

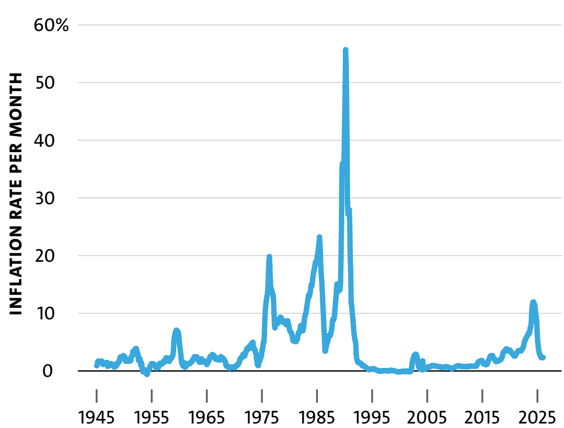
MILEI'S POLICY REVOLUTION

In the November 2023 runoff election, Milei faced Sergio Massa, the economy minister in the outgoing Fernández government. Massa went all out to pump up the economy and pay off key constituencies before the election – a classic political budget cycle. Year-over-year inflation, already running at 100 percent at the start of 2023, doubled by the end of the year.

Voters had had enough of established politicians. Despite having little political experience – he had gained popular recognition as a television personality – Milei won in a landslide.

Milei's radical economic platform promised to take a chainsaw to the government budget, to dismantle the web of regulations smothering the economy, and to "dollarize" – that is, to replace the Argentine peso with U.S. dollars. (Currently, the much smaller

ARGENTINE INFLATION SINCE 1945



NOTE: Year-on-year inflation expressed as an inflation rate per month

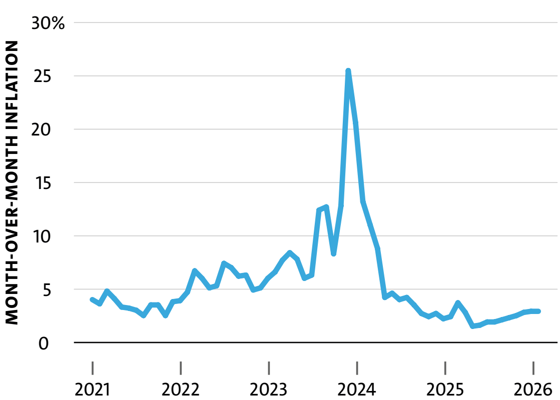
SOURCE: Author's calculations based on data from the Banco Central de la República Argentina economies of Ecuador, El Salvador and Panama are dollarized.) Milei stepped back from dollarization after taking office, but he did slash the national budget and erased a deficit that had been running at about 5 percent of GDP. He also scrapped a complex array of trade and price controls. Monthly inflation, running at an annualized rate of more than 1400 percent per year in December 2023, plummeted quickly.

What explains the rapid turnaround in a country where high inflation has been so endemic? Milei's fiscal bloodletting and his willingness to tolerate the accompanying recession convinced economic actors that deficits would no longer be financed by printing money.

This had immediate inflation-reducing effects. The Nobel economist Thomas Sargent explained the mechanism at work in a classic 1982 paper on historical episodes of rapid inflation reduction:

> This is not to say that it would be easy to eradicate inflation. On the contrary, it would require far more than a few temporary restrictive fiscal and monetary actions. It would require a change in the policy *regime*: there must be an abrupt change in the continuing government *policy*, or *strategy*, for setting deficits now and in the future that is sufficiently binding as to be widely believed.

AFTER A SPIKE IN 2023, ARGENTINE INFLATION FELL SHARPLY AFTER MILEI TOOK CHARGE



NOTE: Year-on-year inflation expressed as an inflation rate per month
SOURCE: Banco Central de la República Argentina

A sharp departure from Argentine business as usual is exactly what Milei was attempting. But to cement the perception of regime change and prevent inflation from returning, further action was necessary.

MANAGING INFLATION THROUGH THE EXCHANGE RATE

A supporting element in Milei's strategy was to move the peso's dollar exchange rate (the price of dollars in terms of pesos) to a more realistic level, and then to enforce a specific low rate of currency depreciation over time (in economic jargon, a crawling peg) by letting the desired exchange rate determine the overall stance of monetary policy rather than the reverse.

In other words, the central bank was instructed to adjust the money supply to match money demand, given the promised path for the exchange rate. The central bank controlled the exchange rate by exchanging dollars for pesos in the foreign exchange market, and the strict controls over private cross-border financial transactions that Milei initially retained made this easier.

Under this approach to monetary policy, the exchange rate serves as a *nominal anchor* for the economy, a strong signal of where prices are headed. It ties the peso prices of internationally tradable goods to their global dollar prices, with a major impact on the overall price level that Milei's trade liberalization measures made stronger and more direct.

Upon entering the presidency, Milei carried out a large, immediate devaluation of the peso followed by implementing a crawling peg that initially forced the currency to depreciate by 2 percent per month against the

U.S. dollar. That imposed depreciation rate was reduced to 1 percent a month starting in February 2025. Milei, in effect, was following policies consistent with a longer-term inflation rate of 1 percent per month – still high by international standards, but much lower than Argentina had experienced in the recent past.

Reducing this rate of crawl further over time might have been one approach to bringing inflation to international levels, which averaged about 5 percent per year before the Iran War – and which Milei's economic team has put forth as a long-term goal. There was one major catch: Milei would need to convince people that the commitment to the exchange rate's future path was unshakable. Otherwise, inflation expectations (and therefore inflation) would not fall durably.

As it happens, the strategy of reducing inflation by controlling the currency exchange rate had been tried many times in the past, including in Argentina. The approach has failed more often than not, and notably failed in Argentina. While Milei's personal commitment was unquestionable, several factors common to earlier failed exchange-rate based stabilizations threatened his program's success.

One major vulnerability was the Argentine government's low holdings of foreign exchange reserves, which it needed both to peg the peso's exchange rate to the dollar and to repay its extensive debts to the IMF and other external creditors. In the run-up to the 2023 elections, Peronist economy minister Massa had run the country's reserves down to very low levels. In the IMF's accounting, net foreign exchange reserves (reserves minus dollar borrowing) were actually *minus* $8.5 billion when Milei took office.

A second vulnerability was the ongoing process by which inflation consistently ran at a much higher rate than the peso's scheduled depreciation under the crawling peg, a phenomenon economists call "real currency appreciation." This made imports progressively less expensive in peso terms, worsening the trade balance and reducing the country's earnings of much-needed dollars from exports. The government hoped to fill the gap by inducing Argentines to convert some of the quarter billion dollars they had squirreled away in mattresses, safes and offshore accounts into pesos. But this effort yielded fewer dollars than were needed.

THE APRIL 2025 IMF PROGRAM

With dollar reserves still perilously low and falling, Argentina (again) sought relief from the IMF. In April 2025 the IMF committed $20 billion over four years. And it made $12 billion available immediately, a departure from its common practice of doling out smaller sums while monitoring program compliance. To bolster reserves further, Argentina simultaneously renewed a $5 billion currency swap with China.

Milei also moved to mitigate the peso's real appreciation. He changed the crawling peg to a wider crawling band, with upper and lower limits on the peso/dollar exchange rate expanding at 1 percent per month. The hope was that additional exchange rate flexibility would allow market forces to determine the exchange rate, with the band as a fail-safe in case of extreme volatility. In addition, the upper limit of the band was expected to provide monetary policy with its nominal anchor.

In implementing the new IMF program, Milei made another fateful move that would imperil his new exchange-rate framework quickly enough. His government lifted most controls that had limited both residents' ability to buy dollars with pesos and importers' freedom to pay dollars to foreign suppliers. This change made the credibility of the exchange rate limits even more important, as suspicion of an impending devaluation could fuel massive resident purchases of dollars, further draining official reserve buffers and depleting the government's ability to defend the upper limit of the exchange rate band. In turn, this possibility threatened the nominal anchor on which future inflation control rested.

Potential currency instability became reality in September 2025. Midterm legislative elections were set to be held on October 26, 2025, and Milei needed to increase his strength in the National Congress to prevent Peronists from passing bills sabotaging the government's economic program and overriding presidential vetoes.

But the president's popularity had fallen. Not only were many in the economy struggling as high real interest rates held the economy back but scandals involving Milei and his sister were damaging his administration's claim to have risen above the corrupt past.

Just seven weeks before the national legislative elections, the Buenos Aires provincial legislative elections gave Peronists a 14-percentage-point vote advantage over Milei's party. Speculation against the peso erupted, and within 10 days the peso was at the top of its band, with the government desperately bleeding reserves to keep the currency from depreciating further. The increasing likelihood of a currency collapse placed Milei's entire program in danger, which would have spelled sure disaster in the upcoming October election.

ENTER BESSENT

That's when Treasury Secretary Bessent said he would "do what is needed" to rescue the peso. The peso rallied as Bessent pledged a $20 billion swap line to the Argentine central bank – in effect, a line of credit – and, in an unprecedented move, intervened directly in the Buenos Aires foreign exchange market to buy a reported $2.5 billion in pesos.

In retrospect, the Trump administration's commitment to intervention in Latin America, financial or otherwise, was not yet as clear as it would become. To be sure, Trump's exorbitant tariff on Brazil's exports to the U.S. in retaliation for proceeding with the prosecution of former president Bolsonaro was announced in July, and the first strikes on small boats in the Caribbean occurred earlier in September. But Trump's more aggressive initiatives mostly came after the release of the National Security Strategy in November 2025, with its new Trump corollary.

Trump's interest in Latin America was intermittent during his first term. He supported the Venezuelan opposition and the IMF loans to Argentine President Macri, and he imposed a U.S. citizen loyalist as president of the Inter-American Development Bank, but with no obvious overarching strategy for the region.

The Heritage Foundation playbook for a second Trump term, *Project 2025*, goes further, but not as far as Trump has now gone. It bemoans China's inroads in the region, singles out Maduro's depredations, recommends cooperative action on drug interdiction, and calls for "re-hemisphering" manufacturing and industrial activity. Quaintly, in light of Trump's second-term demolition of USAID, some of the most detailed recommendations for Latin America are laid out in the Project 2025 chapter on USAID, in which Heritage lauds the agency's efforts to counter Chinese influence under the first Trump administration and urges their extension. In the event, soft-power investments have not been the central element in Trump's intensified attention to the region.

The U.S. Treasury's currency interventions did have the effect of relieving the pressures on the peso long enough to provide a "bridge" to the October 26 election, as Secretary Bessent described it. No one could doubt that the United States had the means to peg the peso to the dollar, even if Argentina did not.

But the decisive factor that saved Milei and the peso was his overperformance in the midterm election. Voters plainly did not want a return to Peronism. Milei's party gained 41 percent of the vote, more than 16 percentage points ahead of the Peronist coalition and enough to sustain Milei's vetoes in the National Congress. The path was cleared to implement further liberalizing reforms and run on those reforms in 2027.

A centerpiece accomplishment was the Labor Modernization Law of February 2026, which, to the fury of the Peronist opposition, loosened employment regulations and permitted firm-level wage bargaining. But introducing these changes at a moment of weak employment could prove politically challenging.

TK TOMAS CUESTA/GETTY IMAGES

ADRIFT WITHOUT AN ANCHOR

Having weathered the immediate currency crisis, Argentina changed its exchange rate regime, effective January 1, 2026. The new system was designed to avoid the problem of real appreciation that could occur when the crawl rate of the band's upper edge was below the inflation rate. It did so by indexing the rate of crawl to the inflation rate two months earlier. For example, with a November 2025 (monthly) inflation of 2.5 percent, the band expanded by 2.5 percent in January, rather than the previous 1 percent, exactly counteracting the lagged effect of inflation. Immediately, the band of currency flexibility began to expand more quickly.

While this scheme addressed one problem – enforced real peso appreciation – it created another. Monetary policy now lacked a nominal anchor. Whatever inflation rate prevailed in a given month would determine the maximum rate of currency depreciation two months later. Conversely, the rate of currency depreciation two months ahead would drive inflation in that month by dragging up import prices. The new system was entirely self-referential, with no concrete anchor to pin down the path of prices or inflation expectations. Nothing in the system works to force inflation down to the central bank's stated goal of converging to global average inflation levels. If inflation accelerates, the upper edge of the policy band follows suit with no natural limit.

To complicate matters, the government must also accumulate enough dollars in reserve to defend the exchange rate band in case of attack and to help service its extensive hard currency payment obligations to foreigners coming due over the next quarters. To do this without igniting more inflation – by purchasing the needed dollars from the public with pesos – depends on the public being eager to convert dollars into pesos at scale and hold the pesos as cash.

Lacking such a sufficient increase in the demand for pesos, the government has deployed an array of Rube Goldberg-like ploys to meet its obligations. For example, in late December 2025, it repaid a $2.5-billion drawing on its U.S. currency swap line using funds obtained from an "unnamed multilateral institution." Analysts believe that institution was the Bank for International Settlements, which may have accepted Argentine gold reserves as collateral – gold that Milei had spirited out of the country to London or Switzerland in June 2025. Likewise, in January 2026, Argentina was able to repay several billion dollars to private creditors by entering into a repurchase agreement with six big foreign banks, including a Chinese bank, using heavily discounted government sovereign bonds as collateral.

Despite purchasing $5.5 billion from the public with pesos through April of this year, Argentina's net reserves remain short of IMF targets as these purchases were mainly used to meet debt-service obligations. All this amounts to running to creep forward.

An easier route forward would be for Argentina to take advantage of its improved reputation in international capital markets to simply borrow dollars and repay previous creditors, much as Ecuador did in January 2026. But Milei's team apparently views such market-rate borrowing as too expensive. The president prefers to find ways to reduce the government's total indebtedness rather than rolling over past foreign debts or relying on cheaper alternative financing.

Argentina will have to pay foreign creditors around $11 billion in the second half of 2026 and more than $30 billion in 2027, sums that may be challenging to accumulate absent further support from the U.S. Treasury or multilateral institutions like the IMF and World Bank. Early in 2026, Argentina's finance secretary resigned over the government's delay in tapping the private global capital market.

Under Argentina's new exchange rate framework, official measures of consumer inflation have been stuck above 2.5 percent per month since late 2025 – an annualized rate of 35 percent per year – rather than declining as the government would prefer. Energy-price escalation due to the war in Iran may add further to inflation, and the increase will automatically feed through to the exchange rate band. That monetary fragility, coupled with higher unemployment (still over 7 percent) and the potential need for further bailouts, could undermine Milei's currently strong political standing as the October 2027 presidential election nears.

A BETTER WAY

The OECD reckons that 11 countries in Latin America and the Caribbean now have central banks that target inflation rates, in common with the norm in developed economies. Inflation targeting must be based on an independent but politically accountable central bank, a floating exchange rate regime, a publicly announced target for inflation (the system's nominal anchor) and the flexibility to adjust a policy instrument – for example, a short-term interest rate – to restrictive settings when inflation is above target. Inflation targeting has delivered good results even in the face of domestic political turmoil (Peru being a notable example) and global shocks like Covid-19.

The table on page 35 shows the experience of the five earliest adopters of inflation targeting in Latin America, all of which embraced it around the turn of the millennium after long histories of very high inflation. Their inflation reductions have been big and so far, durable.

Like some of these countries, Argentina could start with a relatively high short-term inflation target (albeit a target below current inflation) and plan to reduce it over time.

AVERAGE ANNUAL INFLATION FOR LATIN AMERICAN EARLY ADOPTERS OF INFLATION TARGETING

	BRAZIL	CHILE	COLOMBIA	MEXICO	PERU
1990 - 1999	665.4%	10.8%	21.4%	20.2%	793.9%
2000 - 2009	6.7	3.3	5.9	4.9	2.5
2010- 2019	5.9	3.1	3.8	4.0	2.9
2020 - 2025	5.8	5.8	6.6	5.2	4.0

SOURCE: IMF

Market expectations could coalesce around this nominal anchor, which is lacking in the current Argentine framework.

With a floating exchange rate rather than the crawling peg, Argentina would have less need to use reserves for foreign exchange intervention and less reason ever to restrict international payments. This would allow an earlier return to financing on better terms from global capital markets. These reforms would provide a favorable backdrop to realize the country's growth potential and spur inward investment.

A DELICATE BALANCE

President Milei is currently in a relatively strong political position and has accomplished reforms unprecedented in the Argentine context, but Argentina's policy framework remains too vulnerable to reversals. Renewed pressures loom in the forms of continuing weak employment, lagging government revenue and persistent attention to corruption in the president's circle.

With a presidential election due in 15 months, Milei faces a credibility trap. Should the success of his program become widely doubted, his political prospects could deteriorate, making the return of Peronism more likely – a prospect that damages current economic performance and adds to fears of future inflation. Milei should make his policy framework more resilient to economic shocks, which have become more frequent in an increasingly turbulent world.

As in the 19th century, Argentina remains resource-rich with enormous potential. Its Vaca Muerta shale formation holds huge reserves of gas and oil. Argentine farmlands are still extraordinarily productive. Significant deposits of lithium, copper, uranium and other sought-after elements have yet to be fully tapped. Finally, Argentina has a talented, well-educated workforce. Macroeconomic and political stability are prerequisites for the effective mobilization of these resources.

Under Trump, the United States may not prove a steadfast ally if Milei's political fortunes waver. On the other hand, if Milei succeeds and finally breaks the hold of Peronism, other countries in Latin America may well adopt aspects of his approach – as Secretary Bessent hopes. But theorists of a "Western Hemisphere first" version of Trumpism should be careful what they wish for.

Latin American countries, including Argentina, depend strongly on trade with China and the European Union, among other non-U.S. trade partners, and they will not easily accede fully to the "Trump corollary." Many will resist other possible U.S. demands, such as pivoting away from renewable energy use. A strong and democratic Argentina that has overcome the politics of the past and reclaimed some of its 19th-century economic mojo could shake off U.S. domination and return to its traditional independence in foreign relations.

The Baby Boomers are turning 80!

BY WILLIAM H. FREY

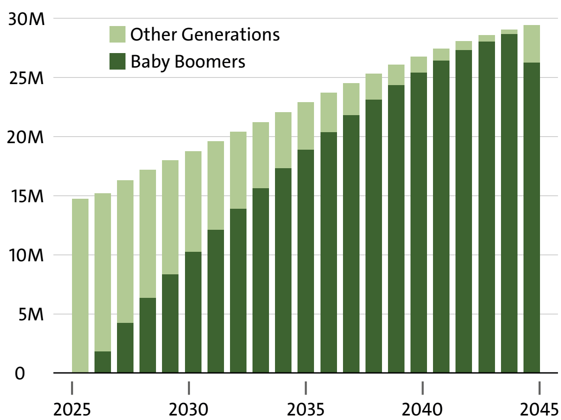
Yes, baby boomers, it's official: you're getting really old. This year, America's first boomers – born between 1946 and 1964 – are reaching the age of 80. Once subscribing to the slogan "Don't trust anyone over 30," this giant cohort numbering 79 million at its peak and still above 66 million, has made a huge, distinct impact on many aspects of the nation's social, cultural and economic life. During their younger years, boomers advanced the causes of civil rights and women's equality, setting the stage for broader shifts among later generations. They have affected the business world and popular culture in ways that still endure, and have installed four presidents in the White House, each serving two terms. ¶ This seems an opportune time, then, to look back to understand how they compare to the generations before and after them, as well as how their influence may change in the coming years.

PHOTO MEDIA/CLASSICSTOCK/GETTY IMAGES

BABY BOOMERS WILL SOON DOMINATE THE OLDEST OLD

Boomers were born in an America that had finally shaken free of the traumas of the Great Depression and World War II. And as they age, what started as a rivulet will become a flood: thanks to the boomers, the nation's 80-plus population group is projected to double, from 14.7 million in 2025 to 29.4 million in 2045.

PROJECTED U.S. POPULATION AGED 80+

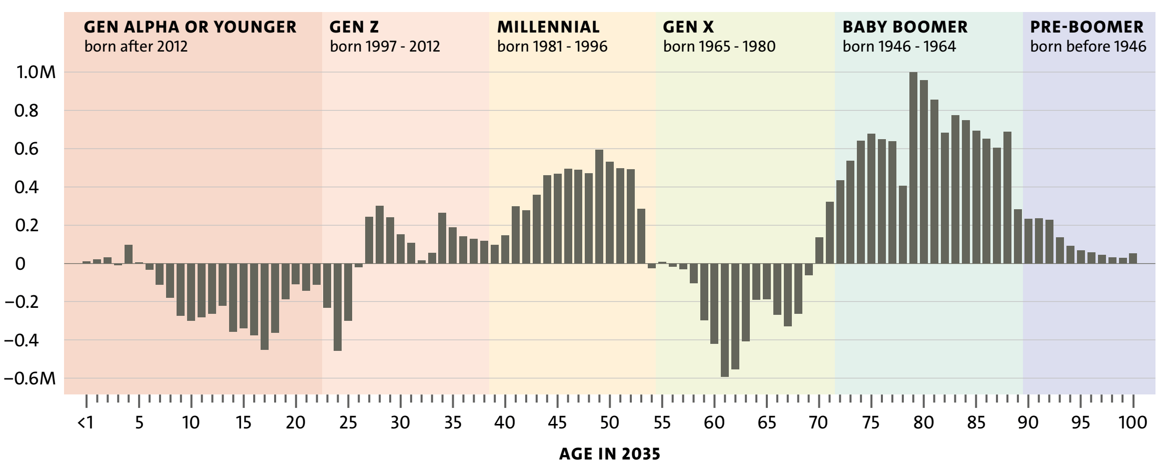


SOURCE: Author's analysis of U.S. Census population projections

Often likened to iconic novelist Antoine de Saint-Exupéry's "pig in the python," the baby boomer generation created its demographic power by sustaining exceptionally high numbers of births for the 19 years following World War II – presumably a product of postwar prosperity and the fervent embrace of family life in the wake of wartime dislocation. Because the boom followed more than a decade of low fertility, the boomer generation continued to increase the size of the age groups it entered. And because the fertility explosion was followed by more modest birth numbers in the Gen X cohort, the body of the metaphoric python shrank behind them.

Over the 2025-35 decade there will be a striking rise in the population group aged 71 to 89 as baby boomers age in. At the same time, there will be a corresponding decline in the population aged 55 to 70, as the baby boomer generation departs. The figure below also shows positive shifts in 2035 for the 39-to-54 age group (gains associated with the somewhat larger millennial generation); more modest gains for the 27-to-38 age group

PROJECTED 10-YEAR NET CHANGE IN U.S. POPULATION BY AGE



SOURCE: Author's analysis of U.S. Census population projections (the older part of Gen Z); and declines for the under-26 age group. Overall, though, the biggest positive changes occur for those age groups the baby boomer generation is entering, reflecting the pig-in-the-python at work.

In fact, over the next 20 years, this dynamic is guaranteed to make the nation's "old" population even older. In 2025, nearly half of the age 60-plus population had not yet reached age 70. By 2045, this share will shrink to 39 percent. Over those same 20 years, the share of people over age 60 who have reached age 80 will top 29 percent, compared with just 17 percent in 2025. And as boomers inflate the size of the "older old" senior population, their problems are sure to become yours. They may be the healthiest elderly ever, but disproportionate numbers will have chronic health conditions that require expensive care.

The demographic reality is locked in: over this time, the U.S. population will continue to age. The nation's youth population showed an absolute decline in numbers between the 2010 and 2020 census – a decline projected to continue into the foreseeable future. This will lead to a shift from what demographers term a "youth dependent" population to an "age dependent" population – that is, a shift in whose dependence will weigh most heavily on the working-age population. While the 65-plus population is typically thought of as the group that is of retirement age and therefore dependent on those working, one might speculate that as baby boomers stay relatively healthy and choose to work longer, it's the 70-plus population that will comprise the new "senior dependent" population.

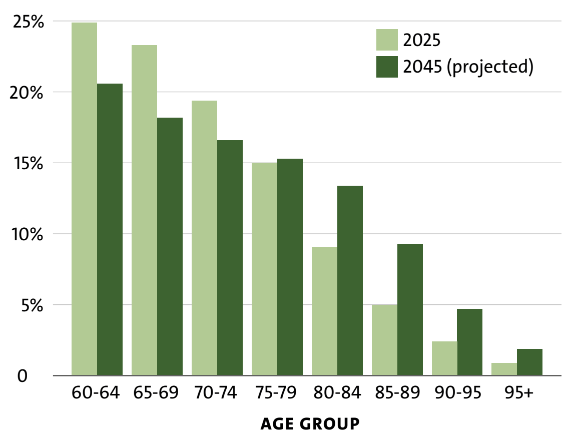
Even with this assumption, census projections show that in the year 2034 the nation's 70-plus population will exceed the size of the under-15 population, making boomer seniors a central focus of the next decade's senior dependent population. Moreover, likely declines in the younger working-age population – particularly declines among those working in health care – will make caring for older seniors ever more of a challenge.

BABY BOOMERS ARE MORE RACIALLY DIVERSE AND BETTER EDUCATED

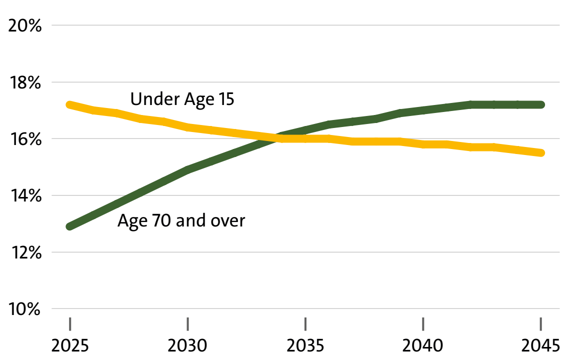
Boomers bring something different to the table in terms of demographics as they move into senior-hood, just as they did at younger ages. Two important ways boomers differ from prior senior generations are their racial/ethnic diversity and their level of education.

Boomers as seniors are already more racially

SHARE OF U.S. POPULATION OVER AGE 60



CHANGE IN SHARE OF U.S. POPULATION AGE 70 AND OVER AND UNDER AGE 15



SOURCE: Author's analysis of U.S. Census population projections diverse than their predecessors. According to the Census Bureau's Current Population Survey, in 2025 the boomer generation as a whole was 71 percent white, 11 percent Latino/Hispanic, 11 percent Black and 6 percent Asian American. This is quite a shift from the previous generation, which at the same age in 2005 was 80 percent white, 7 percent Latino/Hispanic, 9 percent Black and 3 percent Asian American. The larger minority population of baby boomers today reflects growing up in years that saw large immigrant populations augmenting the native-born boomer cohort.

This is made even more apparent in the projections displayed on page 42, which show that by the time all surviving boomers are over 80 (which will be in 2045), the total 80-plus population will be more diverse (30 percent nonwhite) than it was in 2025, before boomers started joining the octogenarian set.

This will incentivize government and private sector programs caring for seniors to broaden their focus to the needs of individuals from different backgrounds, languages and family networks, blazing the trail to accommodate even more racially diverse future generations when they reach their senior ages.

Then there's the impact of education. The baby boomers benefited greatly from post-World War II programs in the 1950s and 1960s that raised the quality of public schools, as well as federal government programs such as the Higher Education Act of 1965 that enabled them to attend college in historic numbers at a reasonable cost.

The impact of the boomers on the average education levels of seniors can be seen in the figure on the next page, which displays the education attainment of seniors age 70 to 79 for both early and late silent generation adults (in 2005 and 2015, respectively) along with those of early baby boomers in 2025. The charts on page 41 show men and women separately, with both groups showing great progress raising shares of post-high school education.

The rise in educational attainment among women is especially striking, though they didn't catch up to men. When they were between 70 and 79, just 14 percent of early "silent generation" women were college graduates. This figure rose to 22 percent for late silent generation women of this age, and then to 34 percent for early boomer women. Women's greater educational attainment is consistent with broader shifts in women's roles, including greater attention to careers and changes in family structure associated with their greater independence.

BOOMERS' INFLUENCE ON SUCCESSOR GENERATIONS

With all the attention that baby boomers received during the late 20th century, many Americans grew up assuming this generation would remain the nation's largest. Certainly, by the time the last baby boomer was born in 1964, this generation – then comprising 37 percent of the total U.S. population – was seen as a distinct demographic phenomenon. This sense was sustained as the generation continued to augment its numbers with help from new immigrants, reaching 79 million in 1999.

However, the boomers' oversize presence began to decline as numbers of deaths exceeded the arrival of immigrants in their age group. And while the immediate succeeding generation, Gen X, was smaller in size due to fewer births during the years 1965 to 1980 (a period of lower fertility and relatively slow

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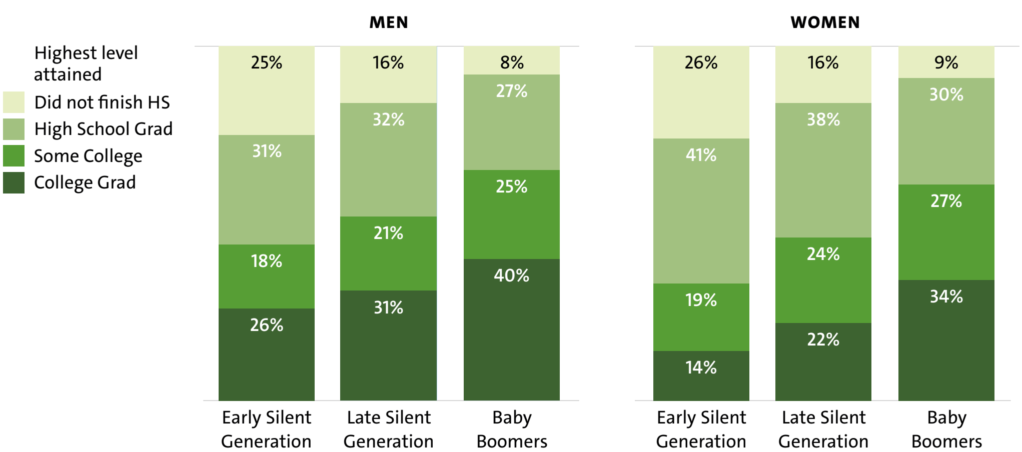
immigration), the size of its successor, the millennial generation, showed bigger gains via both births and immigration. Thus, in 2019, the millennial generation, born between 1981 and 1996, surpassed the baby boomer generation in numbers and since then, so has Gen Z (those born after 1996).

At the time of latest U.S. census estimates in 2024, the boomer generation, with 20 percent of the population, was the third largest behind the millennials (22 percent) and Gen Z at (21 percent), though still ahead of Gen X (19 percent). However, this was not the case in all states. As the map on page 43 shows, baby boomers still comprise the largest generation in 15 states, including the New England states of Maine, New Hampshire, Vermont and Connecticut, as well a swath of states running from Wisconsin to Pennsylvania to Delaware. Florida is an interesting outlier. It is the most populous state in this group, where the exceptional size of the boomer cohort can be attributed to senior migration to sunshine and affordable housing. Yet in many other states, the baby boomer population, while smaller than other generations, is still close to them in size. A notable exception: Utah, where baby boomers represent just 14 percent of the population, compared to 27 percent for Gen Z and 22 percent for millennials.

Notwithstanding its size, there are several areas in which it might be said that the baby boomer generation led the way. As noted above, boomers were more racially diverse than generations preceding them, and the generations that have followed are even more diverse. One reason is the impact of boomer immigrants and their children. In addition to their direct contributions via immigration, they also tend to be younger, with a higher share of women in prime childbearing ages. In a similar way, younger generations – notably, the millennials – extend the trends inaugurated by the baby boomers such as higher levels of education, greater trajectories for women's careers and the formation of a broader array of family types.

EDUCATION ATTAINMENT OF 70-TO-79-YEAR OLDS BY GENDER AND GENERATION



Note: Early Silent Generation aged 70–79 in 2005
Late Silent Generation aged 70–79 in 2015
Baby Boomers aged 70–79 in 2025

source: Author's analysis of U.S. Census Current Population Survey Annual Social and Economic Supplements (ASEC), 2005, 2015 and 2025

Of course, these generational changes have exacerbated some of today's young-old divides, especially with respect to views on immigration and race (something I call the "cultural generation gap"). But it should be recognized that boomers and their children initiated several societal shifts that were taken up by their successors.

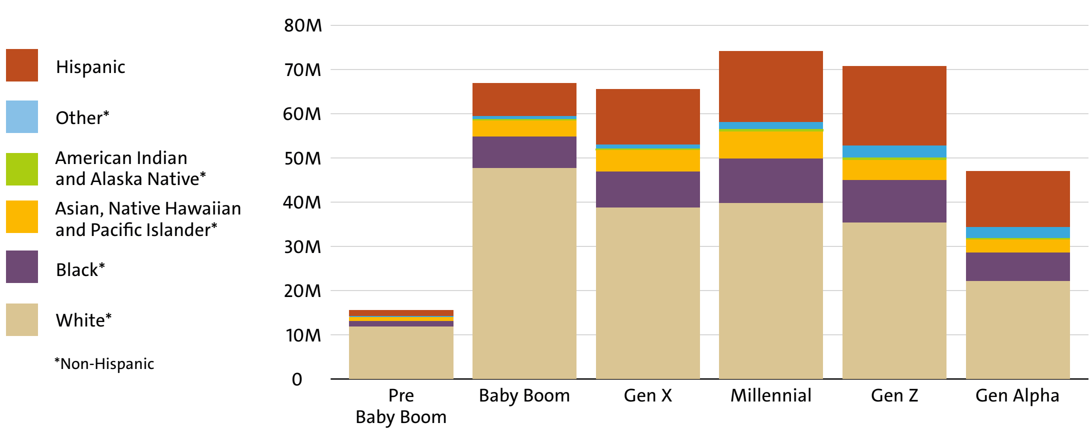
THE BABY BOOMER GENERATION STILL HAS POLITICAL CLOUT

The boomers have a large say in who gets elected in national politics by virtue of the size of the cohort, and there are reasons to believe they will remain influential beyond their numbers down the road. This was clearly the case in the 2024 presidential election, when they comprised 31 percent of all voters. This is a higher share than their share of the total population in part because all the boomers are of voting age, and in part because older voters show markedly higher turnout rates than younger voters.

What is especially interesting about the 2024 election results is that even though Donald Trump bested Kamala Harris, the young-old voting patterns were less consistent than many had anticipated. This was an election with many surprising results, one in which the economy and cost of living proved to be high on people's agenda. Still, with Trump being well-known for promoting immigrant deportations and other policies to block the evolving demographic composition of America, one would have expected his strongest support to come from 65-plus voters. Yet the data on page 44, taken from the 2024 Edison Research exit polls, show that it was the 45-to-64 age group that gave Trump the greatest support of all broad age groups, with a D-R margin (the percent voting Democratic minus the percent voting Republican) of -10. Meanwhile, the 65-plus age group supported Trump by just one percentage point.

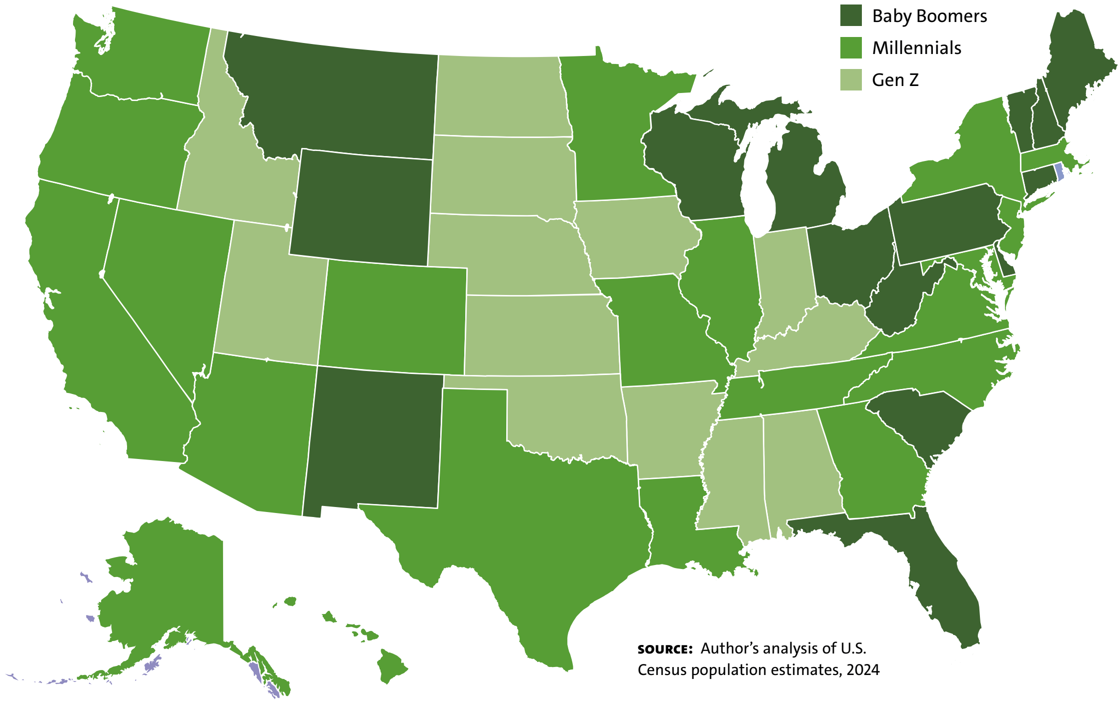
Moreover, when comparing sub-populations within these age groups, Trump actually lost to Harris across 65-plus Latino/Hispanic voters, white college graduates and women voters, despite winning these sub-groups among 45- to 64-year-old voters. And though all Black age groups voted heavily for Harris, 65-plus Black voters gave her the strongest support, with a margin of +87.

GENERATION SIZE AND ETHNIC MAKEUP



SOURCE: Author's analysis of U.S. Census Bureau population estimates, 2024

GENERATION WITH LARGEST SHARE OF STATE POPULATION

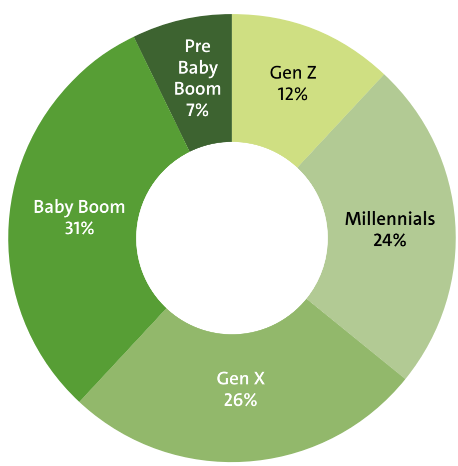


SOURCE: Author's analysis of U.S. Census population estimates, 2024

While the 65-plus age group is a broad one, about three-quarters of its voters were from the boomer generation so it seems reasonable to say that boomers were far less inclined to favor Trump than other seniors. This was confirmed in a separate analysis conducted by the Pew Research Center, which found that among all seniors, only those born in the 1950s – the central decade of baby boomer births – showed a positive margin for Harris (D-R margin of +1), compared with strong Trump support (10+ percentage points) for those born in the 1930s, 1940s and 1960s.

There were presumably many reasons for the tepid Trump support among 2024's baby boomer voters, including differing views on inflation and health care. But the fact that the strongest anti-Trump faction within the boomer cohort were women, people of color and the college-educated suggests much of

SHARE OF LIKELY 2026 VOTERS BY GENERATION



SOURCE: Author's analysis of U.S. Census Current Population Survey 2024 election supplement

this generation's sensibility about race relations, women's rights and diversity had something to do with their voting patterns.

One thing is certain though: the clout of boomer voters will not soon decline. Estimates based on population projections and past midterm elections suggest they will comprise more than 30 percent of all voters in the 2026 midterm elections due to even greater old-age turnout advantages in midterm elections. Both Republican and Democratic candidates should take heed.

BABY BOOMERS AREN'T GOING AWAY QUIETLY

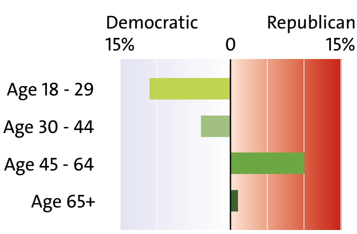
The boomer generation is now entering the "oldest old" age category. Yes, its overall population size will diminish, and there are subgroups including the "okay boomer" crowd that have sharply different views from baby boomers – notably on the economy and the environment. Yet the boomer generation has a history of making its mark in ways that surprise people, often for the better.

That will certainly include altering senior lifestyles and living facilities, along with raising their voices about the need for better health care. But they also have more in common with today's youth than the senior generations they are replacing. As noted, they are the most racially diverse older generation to date, as well as the most receptive when it comes to the changing roles of women. We should keep an open mind about the possibility that the former "don't trust anyone over 30" generation will again draw on its vast experience by building bridges with today's younger generations.

BRIANNA SOUKUP/PORTLAND PRESS HERALD VIA GETTY IMAGES

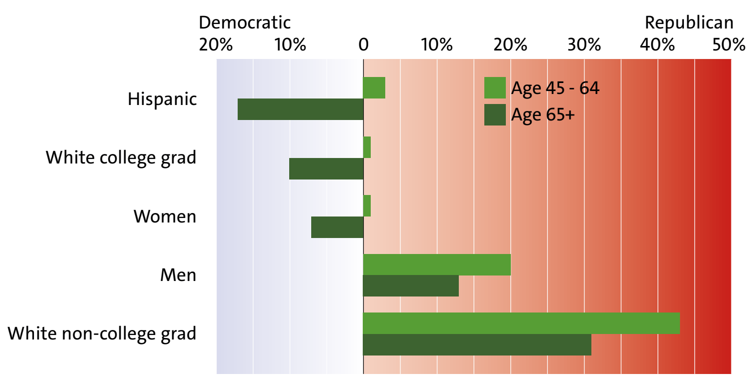
VOTE MARGINS IN 2024 PRESIDENTIAL ELECTION

BY AGE GROUP



SOURCE: Author's analysis of Edison Research exit polls accessed from CNN

BY DEMOGRAPHIC GROUP

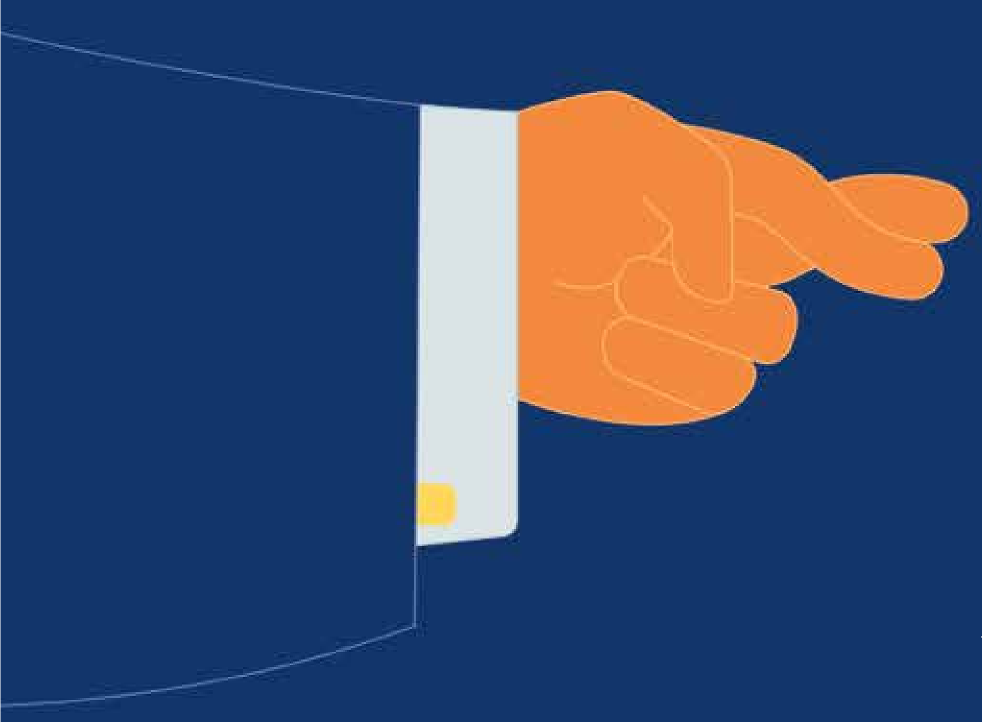


THE AMERICA FIRST INVESTMENTS

Are They for Real?

BY GREG AUCLAIR AND ADNAN MAZAREI

ILLUSTRATIONS BY AAD GOUDAPPEL



Over the past year, a number of the United States' economic partners – among them, the EU, Japan, South Korea, Taiwan and the Persian Gulf oil and gas producers – have pledged to invest close to $6 trillion in the United States. These commitments are part of broader economic and security arrangements negotiated with the Trump administration.

The negotiations have focused on expanding market access for U.S. exporters and increasing imports of specific U.S. goods, while the accompanying investment pledges are meant to support Washington's plans to expand industrial capacity and reduce supply-chain vulnerabilities. Accordingly, the pledges centered around strategically important sectors – notably, energy, semiconductors and critical minerals. In return, Washington has offered lower tariff rates and ongoing cooperation on economic and security issues.

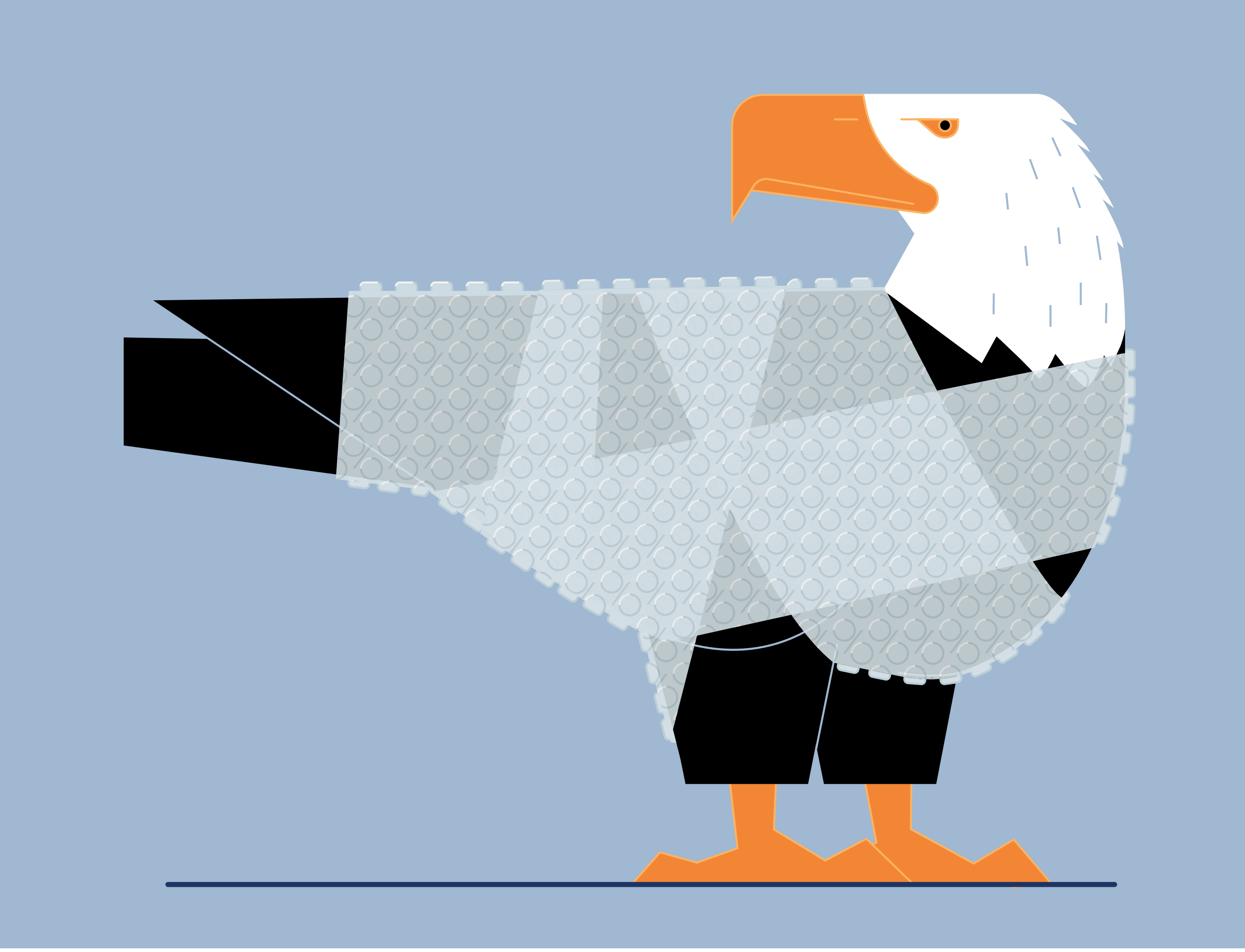
However, the headline figures totaling in the trillions should be treated with caution. Our research at the Peterson Institute for International Economics looks at how these pledges are structured, the channels through which they might be implemented and, ultimately, whether partner countries have the capacity to fulfill them. For several countries, the announced sums are exceptionally ambitious, raising doubts about when (or whether) they can be realized. Implementation will depend on a mix of sovereign wealth fund investments, government incentives for private-sector participation and, in some cases, public borrowing or the reallocation of reserves. Some governments, moreover, may have difficulty corralling the various actors who actually control these resources.

Two subsequent developments raise further questions about the pledges. First, the war pitting Israel and the U.S. against Iran, and Iran's retaliatory attacks have introduced added geopolitical and economic uncertainty, especially for the Gulf Cooperation Council states, which account for nearly two-thirds of the investment pledges collected. Blockage of the Strait of Hormuz has disrupted global energy markets and heightened doubts about the ability of those countries to follow through with their pledges. Second, the U.S. Supreme Court ruled that tariffs imposed under the International Emergency Economic Powers Act lack a sound legal basis. Those tariffs had served as potent leverage in several negotiations tied to the investment pledges.

Yet, while the legal setback could reshape the deals or slow implementation, they will not undo them – and for understandable reasons. For one thing, the United States retains other legal tools to exert trade pressure. For another, many partners rely on the U.S. security umbrella. Their willingness to make the investment pledges was thus motivated by more than tariff threats alone.

Furthermore, the *dirigiste* shift in U.S. policy may outlast the Trump administration. Cross-border investment is no longer being treated as a purely commercial matter best left to market forces, but increasingly as a strategic instrument shaped by geopolitical rivalry and national-security concerns. And given the enduring nature of the pressures on U.S. partners, few are likely to walk away from the investment commitments.

GREG AUCLAIR is a statistician at the Peterson Institute for International Economics. ADNAN MAZAREI, a former deputy director of the IMF, is a senior fellow at PIIE. For a deeper dive into the subject, check out their PIIE policy brief.



PAYING FOR PROTECTION

"America First" investment arrangements are taking shape at a moment when the global economy is becoming more fragmented. Geopolitical rivalry between the U.S. and China, together with persistent global macroeconomic imbalances, is contributing to a gradual reorganization of trade and investment relationships. For decades, the United States absorbed a large share of surplus global savings, reflecting both the dollar's central role in the international financial system and America's provision of what might be termed global public goods, including security guarantees and deep, open financial markets. While that system supported international stability, detractors have argued that it also created domestic instabilities including chronic external payments deficits, a hollowing out of the U.S. industrial base and global vulnerability to the priorities of U.S. monetary policy. Pandemic-era supply chain disruptions only reinforced those concerns.

These abrupt changes have, to say the least, complicated the landscape for U.S. partners. Many face the same structural pressures shaping U.S. policy, including concerns about supply-chain resilience, dependence on China in critical sectors, and broader security risks. But they must also navigate an international environment in which the United States is more inclined to demand economic concessions in return for market access and security support. Across Europe and Asia, governments are scrambling to adjust by strengthening domestic industrial capacity, increasing defense spending and tightening investment screening in sensitive sectors. The result is a world in which trade and capital flows are increasingly shaped by politics and security rather than market forces.

A CLOSER LOOK AT THE AMERICA FIRST PLEDGES

The scale of the pledges raises an obvious question: how realistic are they? In some cases, investment horizons are very long or simply unspecified. Moreover, governments face domestic pressures and have limited capacity to directly mobilize foreign investment by the private sector – or for that matter by most public enterprises. Successful implementation will depend on investors who will weigh U.S. macroeconomic conditions and its investment climate along with other factors.

As shown below, many of the pledges are enormous relative to the size of the economies involved, particularly for the GCC countries and Taiwan. Note, though, that some of these countries have large external asset holdings that make the huge pledges more plausible. For example, Saudi Arabia's Public Investment Fund has around $1 trillion under management. Given this consideration, we construct an illustrative "ability to pay" metric based on three potential sources of external financing: the redirection of 25 percent of outward foreign direct investment to the United States, reallocation of 25 percent of external asset holdings to U.S. foreign direct investment and a shift of 25 percent of imports toward U.S. goods and services (see Figure on page 49). For comparability, we annualized the pledges based on their time horizons, if known. When unknown, we use a 10-year period.

This confirms our initial observation that most GCC countries will have difficulty financing their pledges.

The UAE, Saudi Arabia and Qatar fall below the 100 percent threshold, even if they mobilize a significant share of their external assets. Similarly, South Korea and Taiwan may have some difficulty unless imports from the U.S. are counted against their commitments. While the thresholds we choose are somewhat arbitrary, a 25 percent reallocation of imports to the benefit of the U.S. would by no means be easy. Drawing down reserves may conflict with exchange-rate management in the GCC; in South Korea, it may conflict with financial-stability objectives.

As a final check, we assess fiscal capacity. Countries with low public debt – such as the UAE, Qatar, Switzerland and Taiwan – have greater room to support overseas investment through public borrowing, if necessary. Others, including Japan and Bahrain, face tighter fiscal constraints. Even where fiscal space exists, public borrowing is not a straightforward solution. Issuing debt to support purchases of U.S. assets could crowd out domestic investment.

Our bottom line: some of the pledges are, to say the least, ambitious. The headline com-

AMERICA FIRST INVESTMENT PLEDGES

	PLEDGE $B	HORIZON YEARS	2024 GDP $B	PLEDGE % GDP
UAE[1]	$1,600	10	$552	290%
Qatar[2]	1,200	—	220	546
Saudi Arabia	1,000	4	1,240	81
EU	600	4	19,460	3
Japan	550	4	4,019	14
Taiwan	500	—	797	63
South Korea	350	—	1,875	19
Switzerland	200	5	938	21
Bahrain	17	—	47	36

1 The UAE pledge amount includes $200 billion in "new deals" announced by the White House, in addition to the $1.4 trillion confirmed by the UAE

2 Qatar's commitment is for "economic exchange" with the U.S.

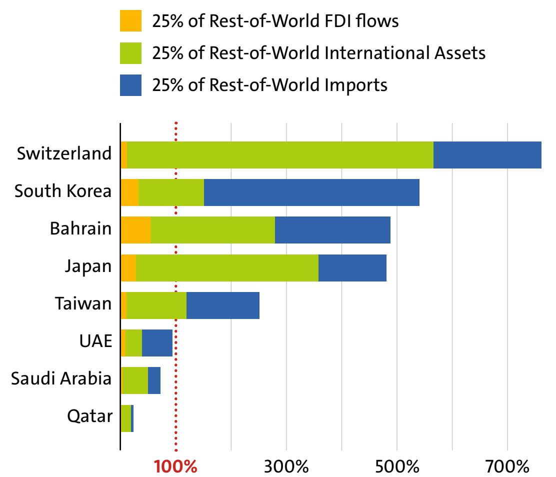
SOURCE: White House Fact Sheets, Government of Bahrain, and IMF World Economic Outlook mitments are thus unlikely to materialize quickly or in full. Still, even partial implementation could have significant macroeconomic implications for the United States. Many projects will likely move forward, particularly where commercial incentives align with U.S. industrial-policy priorities, and the sectoral impacts could be large.

The legal frameworks behind the pledges vary. Some were announced as part of broader bilateral economic discussions with the United States and framed in largely diplomatic terms. Others followed trade negotiations and are part of explicit quid pro quo for tariff relief. Several arrangements also remain politically uncertain. The European Parliament did agree to the U.S.-EU trade deal, but only after tensions over Greenland had died down. In South Korea, implementation of the country's investment pledge remained under debate in the National Assembly despite threats by the Trump administration to reinstate higher tariffs.

Only Japan and South Korea have provided details on the financial terms of their deals with the United States, and those terms appear strikingly lopsided. In both cases, Washington retains effective control over investment

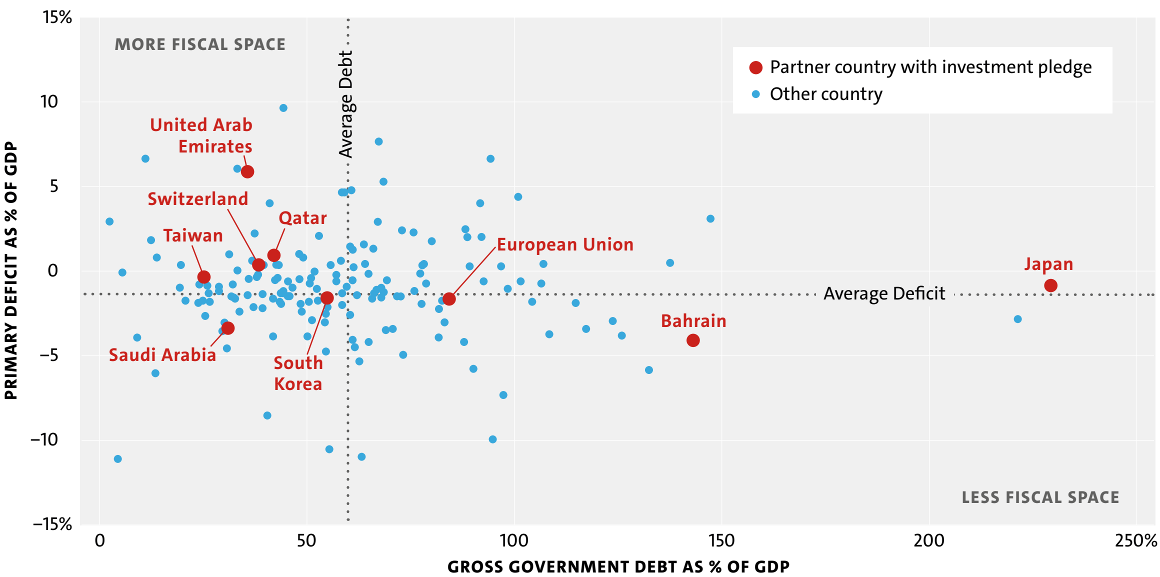
ABILITY TO PAY

POTENTIAL EXTERNAL FINANCING RESOURCES



SOURCE: Authors

COUNTRIES' FISCAL SPACE



SOURCE: IMF World Economic Outlook

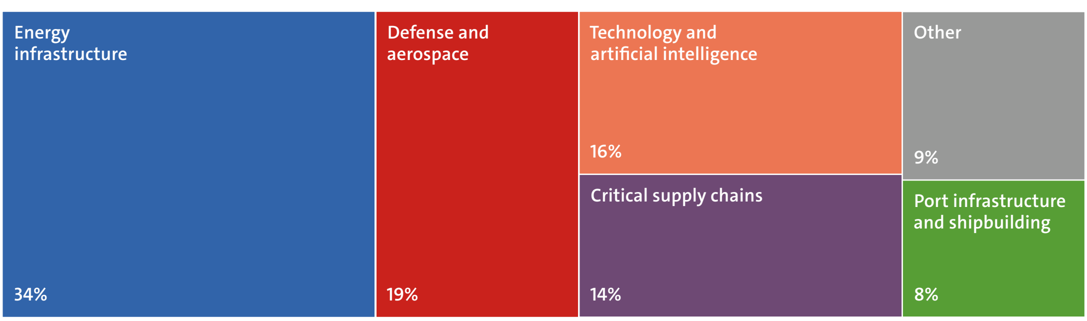
project selection, with the White House retaining final authority over whether projects proceed. Japan and South Korea are required to provide financing quickly for approved projects or face higher tariffs or other penalties. Profits are split 50/50 with the United States until principal and interest are repaid. Thereafter, 90 percent of the profits go to the United States. While South Korea's arrangement pools cash flows from projects, allowing it to offset losses, Japan appears exposed if individual projects fail. Given these terms, we would hardly be surprised if either government seeks to renegotiate if they regain leverage.

As a final point, note that sovereign wealth funds and some public pension funds receive favorable treatment under the U.S. tax code – and that some investments tied to the America First pledges may benefit from these arrangements. However, the future tax status of these projects is not certain. The IRS has discussed narrowing eligibility for such tax exemptions. In addition, initial versions of the One Big Beautiful Bill proposed a "revenge tax" on investors from countries with digital services taxes or undertaxed-profit rules, which were eventually discarded (but perhaps not forgotten).

White House fact sheets for the pledges often highlight commitments by individual firms. These are concentrated in sectors the United States considers strategically important, including semiconductors, critical minerals, pharmaceuticals and advanced manufacturing (see below). The America First agenda supports earlier U.S. initiatives in industrial policy, notably priorities embedded in the CHIPS and Science Act and the Inflation Reduction Act. But there are also some new priorities. Shipbuilding, which now almost entirely consists of military vessels, is currently on the list. Artificial intelligence and the growing demand for data centers have also increased electricity demand, making energy production and infrastructure another one. While the Biden administration pushed for green energy, the Trump administration has made an abrupt U-turn toward fossil fuels.

Not all the projects listed by the White House constitute foreign direct investment in the usual sense. The announcements include contracts with U.S. firms abroad, defense procurement and preference for U.S. goods in imports. Some projects have also been relabeled. A $100 billion semiconductor investment by Taiwan Semiconductor Manu-

DISTRIBUTION OF AMERICA-FIRST-RELATED PROJECT ANNOUNCEMENTS BY SECTOR



SOURCE: White House Fact Sheets. See Auclair and Mazarei, "The America First investment pledges: How are they structured and are they realistic?", Peterson Institute for International Economics Policy Brief 26-2 (2026) for details.

facturing Company, for example, was presented as part of Taiwan's pledge even though it had already been announced earlier. Going forward, the administration will need to clarify whether the pledges refer only to greenfield investment or whether other forms of FDI, including mergers and acquisitions by foreign companies or upstream supply-chain investments, also count.

That distinction matters because, historically, most FDI into the United States has taken the form of M&A rather than greenfield investment. Indeed, over the past decade, greenfield FDI averaged around $40 billion a year, while M&A averaged about $260 billion. Many of the America First pledges, however, emphasize expanding domestic manufacturing capacity and infrastructure. So even if only a modest share of the announced commitments materializes, greenfield FDI would rise well above historical norms.

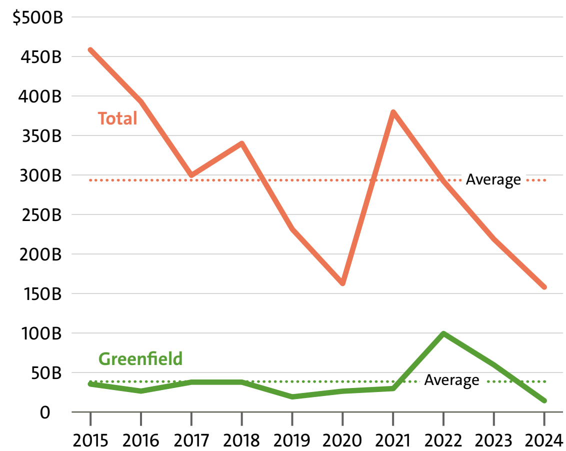
Verification is another open question. Announced greenfield investments have tended to exceed realized expenditures by a wide margin. Announced projects have averaged around $120 billion a year, while (as noted above) official data record only about $40 billion in realized investment over the same period. Some projects may never materialize, while others may do so only after long delays. Moreover, companies plainly have incentives to overstate expected spending and to include outlays that fall outside the standard definition of FDI. And because the Commerce Department's Bureau of Economic Analysis measures FDI using foreign ownership shares, partial U.S. ownership of foreign multinationals could further complicate the accounting.

RECENT DEVELOPMENTS

Start with the issue of whether the war with Iran will lead countries to reconsider their pledges. The conflict has disrupted shipping for oil and liquefied gas, creating what the International Energy Agency calls "the largest supply disruption in the history of the global oil market."

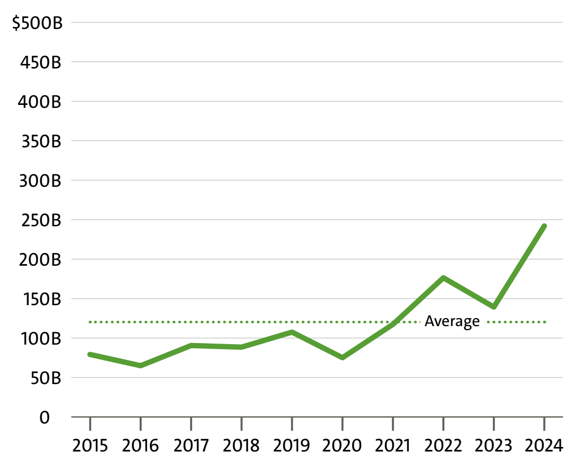
The US-Israel-Iran war is also changing the geopolitical and economic landscape for the GCC countries, affecting their ability and perhaps willingness to follow through with

NEW FDI EXPENDITURES INTO THE UNITED STATES



SOURCE: U.S. Bureau of Economic Analysis

VALUE OF GREENFIELD FDI ANNOUNCEMENTS IN THE UNITED STATES



SOURCE: UNCTAD World Investment Report their pledges. The conflict has interrupted oil and gas production and exports, along with hurting tourism and other non-energy production. The GCC countries are also dissatisfied with U.S. military support against Iranian attacks, presaging some possible geopolitical realignments. The war will also likely lead to increased defense spending in the GCC and will weaken the region's economic diversification model, which is anchored on being a rapidly growing hub for global trade and services.

The GCC's sovereign wealth funds are therefore reconsidering their investment strategies. The departure of the UAE from OPEC could also lead to increased oil production and lower oil prices. All of these developments suggest that the GCC countries will recalibrate their America First pledges – without necessarily reneging on their interest in America First commitments as a whole. The recent rise in energy prices could also weaken the economies of Japan, South Korea and Taiwan, reducing their ability to fulfill their pledges since Asian markets absorb much of the oil that normally moves through the Strait of Hormuz.

The Paris-based International Energy Agency's member countries have responded with the IEA's largest-ever emergency oil stock release, but that can only serve to cushion the shock, not eliminate it. In any event, many of the America First commitments – and, in particular, those from the GCC – appeared ambitious relative to the economic resources available before the war and the Supreme Court decision. The new geopolitical environment increases the pressure on governments to reconsider the timing or scale of their plans.

There's a counterweight to this conclusion, though, since the strategic logic behind satisfying the Trump administration remains intact. Heightened geopolitical uncertainty may even reinforce the incentives for many countries to maintain close economic and security ties with the United States. The most likely outcome, then, is not a collapse of the America First investment arrangements but slower implementation and, in some cases, renegotiation.

The Supreme Court ruling presents a different kind of challenge. The February court decision undid a key legal basis the Trump administration had used to threaten tariffs during negotiations over the America First investments. The administration has since invoked other statutes – notably Section 122 of the Trade Act of 1974 – to impose temporary tariffs (10 percent across the board) anchored on concerns about the U.S. international balance of payments. But the U.S. government suffered another blow on May 7, when these were declared unlawful by a federal trade court.

These rulings thus struck down some of the legal authority the administration had asserted to press its trading partners, but they did not invalidate the broader bargaining power that allowed the White House to force deals on what amount to unilateral terms. The Section 122 tariffs were set to expire in July, and the administration is now turning to Section 301, which allows it to proceed on a country-by-country basis. The USTR is actively conducting investigations targeting China, the EU, Mexico, India and others. The administration may also test Section 338 of the 1930 Smoot-Hawley Act, which allows the United States to retaliate against countries deemed to follow discriminatory trade practices.

The rulings are unlikely to fundamentally undermine the America First investment arrangements. For several participating countries including Japan, South Korea, Taiwan and the GCC states, the pledges are tied to broader security relationships with the

United States. The decision thus may slow implementation or lead to renegotiation of some commitments, but it is unlikely to trigger wholesale abandonment. Note, moreover, that the court's decision did not automatically undo the America First agreements.

Could there be macroeconomic gains for the United States? Foreign investment has long helped drive productivity growth in the U.S. economy. If the America First pledges translate into real greenfield investment, they could expand high-value industries and strengthen the country's position in several strategic sectors. But the gains will depend less on the headline size of the pledges than on the sort of capital – and how much of it – actually arrives, and whether the economy can absorb it efficiently.

On the positive side, additional foreign capital could increase investment in targeted sectors, raising productive capacity, output and employment. If directed toward sectors involved in foreign trade, it could also expand exports. New domestic capacity may strengthen supply-chain resilience as well, although that benefit is primarily strategic – a buffer against geopolitical shocks – rather than a source of long-term growth. On the other hand, large investments concentrated in a few sectors could strain labor markets, push up wages and increase project costs. Large capital inflows may also appreciate the dollar, making U.S. exports less competitive and imports cheaper.

The effects on the U.S. balance of payments are more ambiguous. Foreign investment can improve the trade balance by expanding production capacity and exports, but it also generates income outflows as foreign investors receive returns on their investments. In other words, inward investment can strengthen the productive base while still weighing on net income. Whether the overall effect is positive will depend in large part on whether the investments generate enough additional export capacity and productivity growth to offset those future outflows.

For decades, the international system rested on the assumption that cross-border capital flows should be driven primarily by commercial considerations mediated by markets. That assumption is weakening.

A related question concerns the United States' long-standing "exorbitant privilege." Foreign investors have historically held relatively safe U.S. assets, such as Treasury securities, while U.S. investors abroad have tended to hold higher-return equity investments. As a result, the United States has often earned positive net income from abroad despite running persistent current-account deficits.

If the America First arrangements significantly increase foreign ownership of productive assets in the United States, they could gradually erode this advantage by increasing the share of profits flowing to foreign investors. Notably, the profit-sharing arrangements with Japan and South Korea minimize financial outflows. But together, those two countries account for less than $1 trillion of the roughly $6 trillion pledged.

BIDEN REDUX?

Both the Trump and Biden administrations have deployed industrial policies to support U.S. manufacturing and reduce vulnerabilities associated with dependence on China. The Biden administration relied primarily on subsidies and incentives to attract investment in targeted sectors, while the Trump administration has coerced foreign governments to pay for U.S. industrial expansion.

But it's important to recognize that the America First arrangements are not a complete break with earlier practice, in the sense that the U.S. has long used its political, military and economic influence to extract concessions from other countries. What is distinctive, though, is the way the Trump administration has pursued these aims through public pressure on allies. In particular, the threat of tariffs and other trade restrictions has been used more forcefully to induce partners to make investment commitments.

This reflects both geopolitical and domestic political imperatives. On one level, the administration is using economic instruments to advance U.S. strategic positioning. In recent years, U.S. policy has increasingly relied on tariffs, export controls, investment screening and financial sanctions to pursue national-security goals. But domestic politics matters as well. The Trump administration has argued that U.S. decline reflects unfair treatment by allies and its demand for concessions fits squarely within that political narrative.

Another distinctive feature of America First arrangements is their bilateral and often informal character. The administration has pursued country-by-country negotiations tied to ongoing access to the U.S. market, arrangements that often avoid binding treaty commitments and instead take the form of political understandings or executive agreements between governments. This approach reflects the administration's preference for flexible deals shaped by personal relationships between leaders rather than formal multilateral frameworks. It may also reflect deeper institutional dynamics in the United States, including the growing dominance of executive authority in economic policy, the difficulty of securing congressional approval for formal agreements, and a belief that flexibility increases Washington's leverage.

While it has wielded its tariff stick and pushed through deals, the Trump administration has also looked to facilitate foreign investment by lowering regulatory barriers, at least in part. The Committee on Foreign Investment in the United States (aka CFIUS), an interagency group led by the Treasury, normally screens foreign investment, but its focus has gradually expanded beyond traditional defense concerns.

The White House memorandum on the America First Investment Policy outlines a more nuanced approach that would fast-track CFIUS review for trusted investors and expedite large investments. Meanwhile, the memo identifies China as a foreign adversary and proposes tighter restrictions on China-linked investment along with tighter scrutiny of outbound U.S. investment with the aim of limiting technology transfer to China and other rivals.

WHERE WE'RE HEADING

The developments that motivated our analysis – the Supreme Court ruling on tariffs imposed under IEEPA and the escalation of conflict with Iran – have raised legitimate questions about the durability of the America First investment arrangements. The court's decision weakened one of the legal tools the Trump administration had used to pressure partners into making investment pledges, while disruptions to shipping through the Strait of Hormuz and rising defense expenditures could weaken the financial capacity of some GCC states (and to a lesser extent Japan, South Korea and Taiwan) to implement their ambitious commitments.

Yet these developments are unlikely to spell the end of the America First initiative since for many participating countries the pledges are intertwined with broader strategic relationships with the United States. Implementation may slow and some commitments may be renegotiated, but the incentives to maintain close economic and security ties with Washington remain strong.

Even if some investments do not materialize, the arrangements still mark a shift in the global investment regime. For decades, the international system rested on the assumption that cross-border capital flows should be driven primarily by commercial considerations mediated by markets. That assumption is weakening. U.S. administrations increasingly view foreign investment through the lens of national security, technological competition and geopolitical alignment. The America First arrangements accentuate this shift.

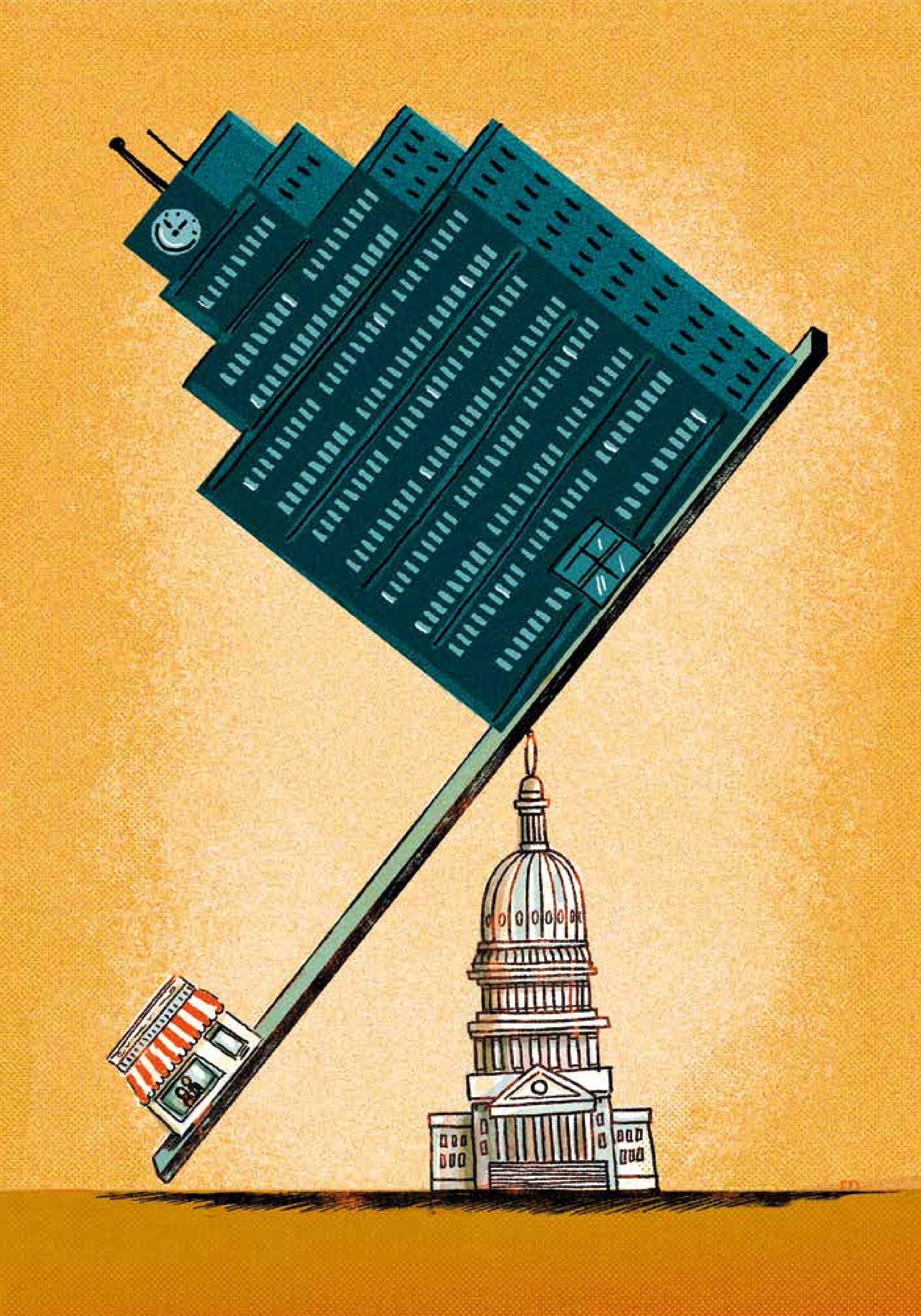
For investors and policymakers, that means a global investment climate that is becoming more political. Strategic sectors – from energy and critical minerals to advanced technologies – are likely to attract particular attention. Some national security concerns are valid. But the return of industrial policy also raises familiar concerns around inefficiency, favoritism and corruption. And if projects pursued under the America First banner are poorly selected or weakly overseen, the U.S. could erode its reputation as a leading destination for investment. At a time when economic governance in the United States is already under strain, the downside risks are significant.

Regulatory Favoritism, LLC

BY BRIAN D. FEINSTEIN

ILLUSTRATIONS BY ROBERT NEUBECKER

Few subjects unite politicians across the political aisle like the imperative to reduce regulatory burdens on small businesses. Small firms are conceived of as "barber shops, beauty salons and pizza parlors" on Main Street and "farmers and ranchers, the sons and daughters carrying on the family business" outside of town. They are lauded as the "heart and soul of the American economy" and the "embodiment of the American dream." Yet, according to the conventional wisdom, they are "punished disproportionately" by federal regulations and in need of "a level playing field to have a fair shot." ¶ This narrative has potent political resonance, and it does contain more than a kernel of truth. But when it comes to discussing the many ways in which regulation actually favors small firms, politicians tend to fall silent. Examples abound. Small debit-card issuers are allowed to charge higher interchange fees to merchants than Chase or Wells Fargo. Small oil refineries can be exempted from renewable fuel standards that apply to Exxon and Marathon. Small telecom equipment and software makers can disregard accessibility requirements for disabled users to which Cisco and Motorola must adhere.



All told, over 1,300 federal statutory provisions bestow advantages on small firms. These provisions confer not only blanket exemptions (a relatively modest category), but also less rigorous monitoring, delayed compliance deadlines and fee waivers. Hundreds of these provisions mandate minimum levels of small-business participation in government programs. Hundreds more compel agencies to show special solicitude to small firms in administrative processes.

What's more, many of these benefits are available not only to those proverbial barber shops and beauty salons straight out of Frank Capra movies, but to firms with hundreds of employees or tens of millions of dollars in revenue.

Considered in isolation, some of these advantages may seem minor. Viewed collectively, however, they challenge the prevailing narrative of small businesses beleaguered by regulation. This regime of preferential treatment for small firms – comprised of measures large and small, salient and subtle – raises questions concerning both the fairness and efficiency of a wide array of federal laws.

This article summarizes my academic research, for the first time documenting the massive body of federal laws that explicitly provide advantages to small firms. Indeed, this broad scope reveals a legal regime of small-business favoritism.

The costs of this regime are significant and often overlooked. Legal preferences for small firms undermine statutory objectives, channel public resources toward less valuable uses, generate unnecessary red tape – and, ironically, undermine firms' incentives to grow to efficient scale. Meanwhile, the usual justifications for these preferences – that they create jobs, spur innovation and counter concentrated political power – are open to serious question. This has led me to conclude that the legal regime favoring small firms is ripe for reform that includes eliminating size-based carve-outs and adopting graduated obligations that increase with firm size.

Legal preferences for small firms undermine statutory objectives, channel public resources toward less valuable uses, generate unnecessary red tape – undermine firms' incentives to grow to efficient scale.

THE OVERLOOKED LAW OF SMALL BUSINESS

The federal government's solicitude for small firms is most visible in a handful of familiar programs, some of them very large. For example, the cabinet-level Small Business Administration helped to deliver over $100 billion in new capital to small firms on favorable terms last year. During the depths of the Covid-19 pandemic, the Paycheck Protection Program, available only to firms below a certain size, authorized more than $800 billion in forgivable (and thus heavily subsidized) loans.

Yet these high-profile examples are only the tip of the iceberg. My research team combed through the U.S. Code to identify every provision that singles out small firms for favorable treatment – not only explicit references to "small businesses" (or "small shipyards," "small insurers," etc.) – but also provisions that set thresholds based on employee count, revenue, assets or production

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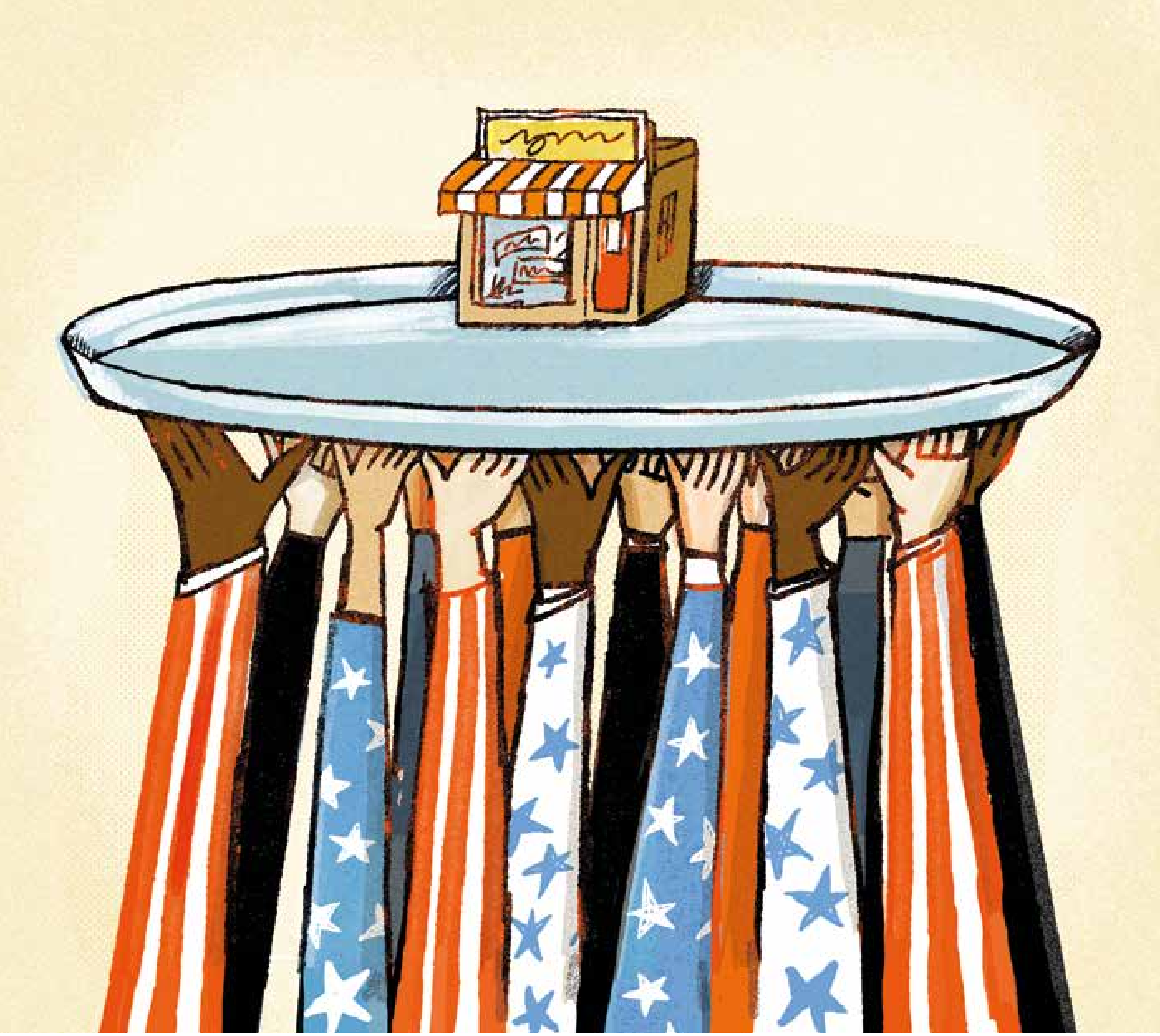

volume. We then reviewed each provision to determine whether it confers a size-based benefit on private entities.

The result is a dataset of 1,311 distinct provisions spread across 302 separate laws and administered by 32 different federal agencies. These provisions fall into seven broad categories: training and technical assistance (415 provisions); loans, loan guarantees and grants (300); government contracting preferences (263); regulatory carve-outs (138); R&D support (92); international trade assistance (67) and tax relief (36). Put simply, Washington helps small firms build expertise, access capital, sell to the government, reduce regulatory compliance costs, profit from inventions, reach overseas markets and reduce tax burdens. Agencies advance these goals by:

- Creating offices or programs focused on small businesses (391 provisions)
- Informing Congress or the public of their efforts (201)
- Issuing regulations or otherwise adopting policies that favor small firms (115)
- Conducting studies at government expense (87)
- Soliciting input from small firms (44)

Some statutory interventions affect small

firms in direct, observable ways: when Congress launches a new program or instructs an agency to adopt particular regulations, those decisions directly shape the conditions under which small businesses operate. Other provisions work more subtly. Mandates that agencies report their efforts to assist small businesses and requirements that they consult with small firms when writing new regulations leave the formal legal rules governing small firms unchanged but can still move policy in meaningful ways.

For example, a requirement that an agency confer with a small-business procurement advisory body does not in itself force the agency to change how it buys goods or services. But it gives small businesses a channel through which to press their views. Similarly, directing an agency to disclose the portion of its contracts going to small firms does not require that any particular procurement contract be signed. But it does make agency performance more visible to Congress and outside overseers, who can then use that information to demand changes or exert political pressure.

Congressional attention to small-business concerns has grown markedly over time. New small-business-favoring provisions proliferated rapidly from the late 1950s through roughly 1980. Beginning in the early 1980s the pace of new enactments leveled off, then began to climb again around 2000. The scale of this legislative expansion is striking: over the past half-century, the amount of statutory text dedicated to small business has grown approximately seven times faster than the rate of growth for all other statutory text.

WHAT BUSINESSES ACTUALLY QUALIFY AS "SMALL"?

There is a further wrinkle that complicates the mom-and-pop vision: the firms that benefit from this legal regime are often considerably larger than the image of Main Street storefronts would suggest. Roughly 88 percent of these 1,311 statutory provisions adopt the small-firm size thresholds set by the Small Business Administration. And the SBA establishes industry-specific size standards for nearly 1,000 sectors.

In industries where the SBA definition is based on revenue, the industry-specific ceilings for eligibility as a small business range from $2.25 million to $47 million in annual sales, with a median of $21 million. In industries where the definition is based on headcount, the limits range from 100 to 1,500 employees, with a median of 825.

Under these capacious standards, enterprises with many hundreds of employees qualify as small businesses for many purposes under federal law despite these businesses being larger than the vast majority of American firms. The construction industry is illustrative. Firms in that sector can take in up to $45 million per year and still qualify for small-business benefits. Given that average net margins in construction run around 6 percent, the owner of a firm approaching this $45 million limit is likely to be doing quite well financially.

These revenue and headcount ceilings are at odds with political rhetoric about small businesses, which is replete with references to "Main Street businesses," "family restaurants" and the like. The term "small business" thus does a great deal of rhetorical work. It invites sympathy by calling to mind genuinely modest enterprises, even though the legal rules frequently extend the same favored treatment to firms operating on a much larger scale.

THE GOVERNANCE COSTS OF FAVORITISM

Small-business favoritism is not just a question of rhetoric. It imposes real costs. I highlight three. First, many small-business carve-outs directly undermine the purposes of the statutes that contain them. The Fair Housing Act, for example, prohibits discrimination in housing – but it exempts small, owner-occupied rental properties. The explicit purpose of that exemption is to permit discrimination that the act would otherwise forbid.

For laws that prohibit or discourage harmful activity, exempting small firms makes little sense. A victim of housing discrimination suffers the same harm regardless of whether the property owner is small or large. The same is true for people protected by food safety rules, environmental regulations, and myriad other regulatory subjects that contain small-firm exemptions. As the legal scholar Paul Verkuil once observed, "It is cold comfort to the miner who contracts black lung disease or to the textile worker who inhales cotton dust" that his employer qualifies as a small business when it comes to workplace safety.

The problem can cascade. When small firms are exempted from, say, safety regulations, production may shift toward the exempted firms and away from their larger, regulated competitors. The net effect is not merely that some miners or textile workers receive less protection than others – it is that economic incentives push employment toward the less-protected firms.

Second, small-business preferences divert public funds from more effective uses. Take government contracting. Firms that win business on their merits tend to grow, with that growth reflecting demonstrated competence. Federal contracting preferences for small firms can invert this logic. More than 200 statutory provisions tilt the playing field toward smaller vendors, including a government-wide requirement that small businesses receive at least 23 percent of federal prime contract dollars each year – a figure that now tops $100 billion annually. Meeting that target can mean passing over the most qualified bidder. Rather than rewarding capability, the system redirects public dollars away from firms that would prevail in competitive bidding and toward smaller firms with inferior bids based on price, quality or other criteria.

Grant and loan programs raise similar concerns. The Paycheck Protection Program is instructive. Aimed at preserving jobs during the Covid-19 shutdown, the program proved strikingly costly per job saved – estimates range from $169,000 to $258,000 per year. Much of this money flowed to creditors and business owners, many of whom were not considering layoffs, rather than to workers. Although some spillage was likely unavoidable given the speed at which the program was deployed, restricting eligibility to small firms added its own layer of waste.

Other developed countries took a different approach during the pandemic, subsidizing wages directly and limiting support to firms that had actually reduced work hours – a better signal of genuine financial distress. That model kept more workers employed at lower public cost.

The underlying principle generalizes: when public resources are scarce, establishing eligibility based on firm size rather than explicit need or impact produces inefficient outcomes. Across many regulatory contexts, size-based eligibility functions less as a policy tool than as an administrative convenience – one that often comes at a high cost to program effectiveness.

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Finally, there are procedural costs. The Regulatory Flexibility Act of 1980 mandates that agencies across government analyze the impact of proposed rules on small firms and consider alternatives that are less burdensome to them. That procedural requirement has real teeth since courts can enforce it. Forty-four additional statutory provisions require agencies to consult with small-business advisory committees before finalizing certain policies. Another 201 provisions mandate reports to Congress or public disclosures about small-business concerns. And 87 provisions require agencies to conduct dedicated studies on the impact of their activities on small firms.

Add it all up and agencies must jump through a bewildering number of procedural hoops related to small firms before they can act. Legal scholars argue that loading agencies with procedural requirements of this kind produces "ossification" – unnecessary delay, excessive caution and an overall reduction in effective governance. At a time of renewed focus on reducing red tape in government, the cumulative burden of these procedures deserves scrutiny.

A HIDDEN TAX ON GROWTH

Perhaps the most economically significant cost of small-business favoritism is one that rarely enters political debate: it discourages firms from growing.

When crossing a size threshold means losing valuable exemptions and benefits, rational business owners have an incentive to remain below it. Prior research has documented precisely this sort of clustering below eligibility caps. In banking, financial institutions tend to bunch just below $10 billion in assets – the cutoff for several important regulatory exemptions – and below $500 million, where mandatory annual audits kick in. In securities markets, many firms manage their public float to stay below $75 million and thereby avoid more extensive disclosure requirements. Similar dynamics are present in European labor markets around thresholds that activate specified job protections.

My research adds new evidence to this picture. Using a commercial dataset covering roughly 50 million U.S. firms, I identified the distribution of firms relative to their sector-specific Small Business Administration headcount thresholds. The figure below displays the distribution of firms whose employment falls within a band ranging from 50 employees below to 50 employees above their industry's eligibility cutoff for small-business status.

Consider, for example, Blue Bird Corp., the school bus manufacturer, with 1,550 employees. The SBA threshold for automotive and light-duty motor vehicle manufacturing is 1,500 employees. Blue Bird sits 50 employees above the cutoff. Therefore, it is located as part of the bar at x = 50.

The figure on this page shows that firms tend to cluster just below their industry's eligibility cutoff. Statistical analysis reveals that the pattern is well beyond what random variation would produce. That clustering is consistent with firms deliberately limiting their headcount to retain small-business status. The figure also shows a greater concentration of firms with 1-50 employees below the cutoff than firms with 1-50 employees above it. That asymmetry provides further evidence that firms organize themselves to remain under the threshold.

The reality that firms cluster immediately below the cutoff to remain eligible for regulatory benefits entails a genuine social cost. Firms that cap their growth to preserve privileges are forgoing expansion that might otherwise be economically efficient and socially beneficial. The benefits of small-firm status accrue to the owners; the foregone growth is a loss to workers who would have been hired, to consumers who would have been served and to the economy at large in terms of aggregate productivity.

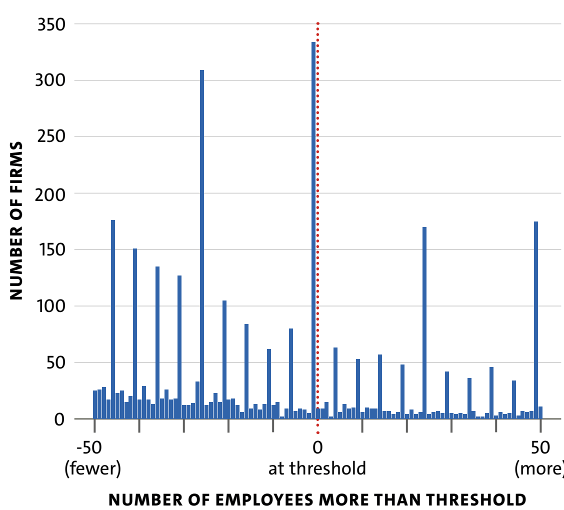
QUESTIONING THE JUSTIFICATIONS

The standard defenses of small-business favoritism rest on two pillars: fairness and economic dynamism. Neither is as solid as it may seem.

The fairness argument begins with the premise that large firms enjoy economies of scale in regulatory compliance. They can

FIRMS WITH NUMBER OF EMPLOYEES NEAR THEIR SMALL-FIRM ELIGIBILITY CAP

DISTRIBUTION OF SMALL BUSINESS FIRMS WITHIN 50 OF THEIR SECTOR-SPECIFIC HEADCOUNT THRESHOLD



SOURCE: The author

spread the largely fixed costs of dealing with monitoring and adhering to regulation across more units of output, while their smaller competitors cannot. From this perspective, exempting small firms simply levels a playing field that is already tilted against them.

The empirical picture is more complicated. Drawing on detailed occupational data for 1.2 million establishments, a trio of researchers found that regulatory costs per employee do not simply decline with firm size. Instead, they rise as firms grow from sole proprietorships to a range of around 250-500 employees, then decline somewhat for the largest firms. Firms with more than 4,000 employees face per-employee compliance costs roughly comparable to those with 20-49 employees. The straightforward, linear economies-of-scale story is just not accurate.

The fairness argument also has a political variant. Proponents of small-business favoritism argue that large firms wield disproportionate influence in Washington – specifically, that large companies with deep pockets can hire armies of lobbyists, make large campaign contributions and entice former government officials with employment opportunities to an extent that smaller firms cannot match. In this telling, small firms' statutory advantages can help address this imbalance in political resources.

There is something to this. Still, small businesses are far from powerless. They operate in every congressional district in the country, giving them a kind of distributed geographic clout that big players in concentrated industries lack. For instance, community banks – a defined category of smaller banks subject to less stringent regulation – are present in every congressional district. Often, their officers and directors are local notables with whom the area's politicians are friends and neighbors. Perhaps not coincidentally, regulatory relief for community banks has long been a bipartisan project in Washington.

Further, surveys consistently show that small businesses enjoy the highest level of public trust of any institution in America – a reservoir of goodwill that may translate into political leverage. In any event, trade associations for small firms in many sectors are formidable political actors. In fact, the evidence is mixed regarding whether firm size and lobbying activity are correlated. Whether small firms, on balance and in the aggregate, suffer a political disadvantage vis-à-vis large firms is thus very much an open question.

Then there is the economic dynamism argument. Here, proponents claim that small firms are an outsized engine of job creation and innovation, and therefore deserve special regulatory support.

This claim is repeated so often in Washington that it has become a mantra. It is nonetheless misleading. Although small firms do account for a disproportionate share of job creation, this effect is largely driven by firm age, not firm size. New firms tend to start small, with those that prosper then growing and hiring new employees; established small firms do not. Once one controls for firm age, the statistical connection between firm size and job creation evaporates.

The innovation story is similarly overstated. Groundbreaking innovation emerges from a range of organizational settings: university laboratories, large corporate R&D departments, government-funded research programs and, yes, small startups. Apple built its first computers in a garage. But it created the iPhone decades later only after it became a corporate behemoth. And the internet – which makes Apple's phones, tablets and watches truly transformative – was developed through federal investment.

Scholars have long debated whether small or large firms are more innovative in general. The economist Joseph Schumpeter argued that large firms operating in concentrated markets are better positioned to drive innovation because they can absorb the fixed costs of R&D, diversify across projects to hedge against failure and exploit economies of scale in translating discoveries into commercial products. Indeed, empirical evidence indicates that R&D spending tends to increase along with firm size. But others have countered that bureaucratic inertia and reduced competitive pressure blunt large firms' innovative instincts.

In any case, few small businesses are focused on innovation. A survey of small business owners shows that most do not invest in R&D, pursue patents or even trademark their firms' names. Once firm age is accounted for, small firms are no more innovative than large ones, on average. Small firms that do generate significant innovations tend not to stay small for long.

WHAT SHOULD CHANGE

None of this means the federal government should drop all preferential treatment of small firms tomorrow. For some provisions, the benefits of favoritism plausibly – and, perhaps in some cases, certainly – exceed the costs. The question is whether each provision deserves its place in the legal code. On that question, the current political consensus has been far too credulous.

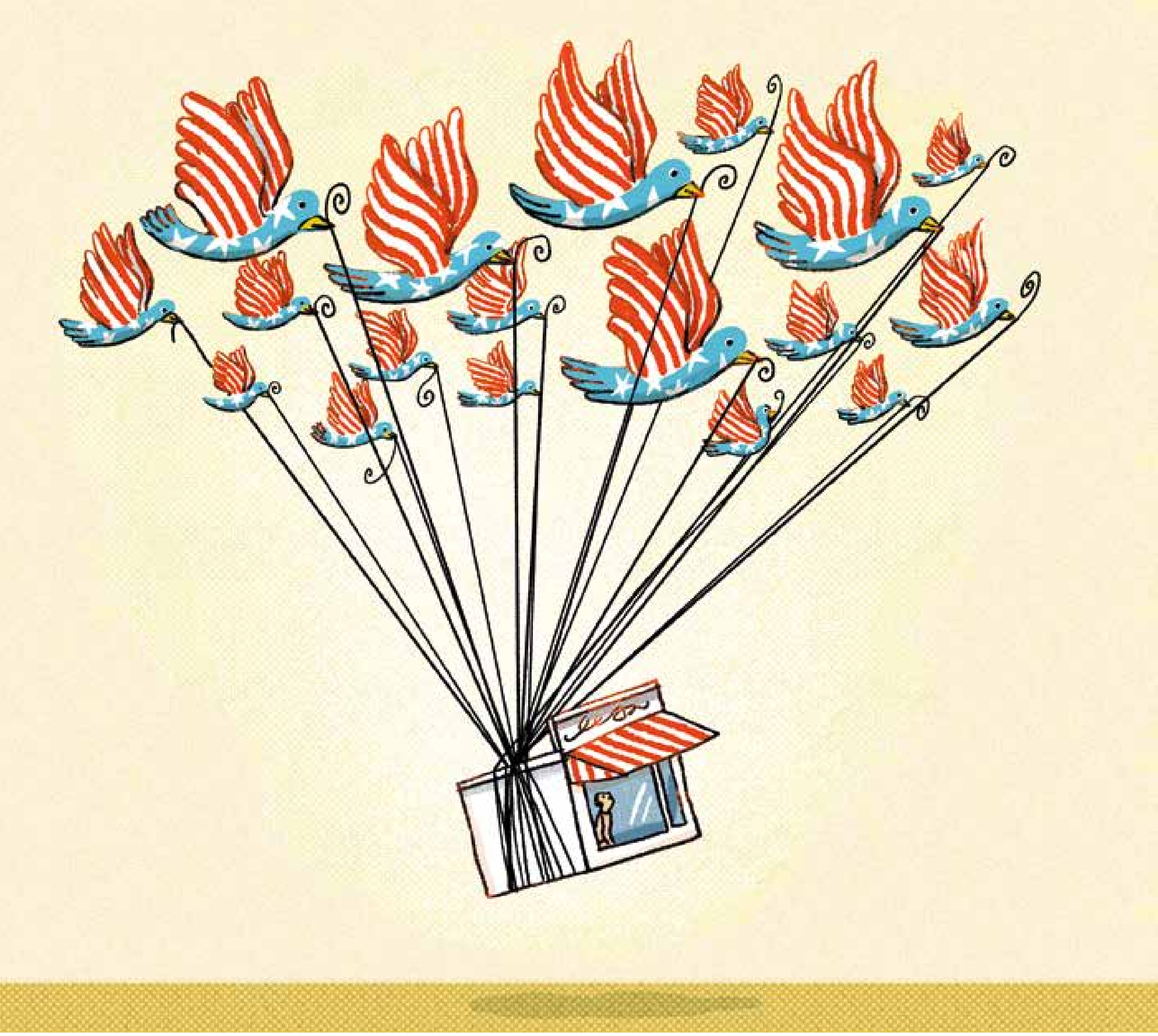
The most compelling case for reform involves ending exemptions from laws designed to address serious social harms. When a statute prohibits conduct because that conduct harms others, the size of the actor is virtually irrelevant to the moral calculus. A small business that dumps a given amount of waste imposes the same environmental costs on neighboring communities as a large firm that does the same.

Environmental laws exist in part to compel firms to internalize this type of negative externality. By exempting small firms, Congress shifts those costs from the firm to the affected communities or the public. Someone has to pay when a firm pollutes, and the question is whether that cost should fall on the polluting firm or on others.

The argument that exemptions are needed because compliance is burdensome for small firms doesn't bear scrutiny well. If a firm cannot compete without transferring part of its production costs – including the costs of properly disposing of waste, reducing workplace injury risk to an acceptable level and otherwise internalizing negative externalities – onto others, then the firm's goods and services are better supplied by rivals that can. Simply because certain firms are less equipped than others to adhere to laws that promote the public good does not, by itself, provide a sound reason to weaken those laws for these firms.

To be clear, I am not arguing for more regulation per se. By requiring firms to internalize the cost of pollution rather than offloading it onto the public, the hypothetical law discussed above is socially beneficial. But if a law does not promote the public good, then

If a law does not promote the public good, then exempting small firms but requiring compliance from larger ones is inadequate – and that law should be stricken from the books.



exempting small firms but requiring compliance from larger ones is inadequate – and that law should be stricken from the books. A political culture that encourages small-firm favoritism gives lawmakers permission to avoid hard questions about whether a law actually benefits society overall, when they can instead just exclude well-regarded small businesses from its ambit.

Going further, eliminating small-firm exemptions could be coupled with trimming legal obligations across the board. This idea borrows from the logic of tax policy. In that domain, broadening the base by eliminating narrow exemptions allows for tax rates to fall for every taxpayer while still collecting the same amount of revenue. Applied to regulation, pairing the removal of small-firm exemptions with modest reductions in applicable standards for all firms could hold the overall regulatory burden constant while distributing it more equitably. Firms that benefit from special regulatory treatment under the current system and firms that bear the full cost would converge toward a more even treatment.

For situations where the complete elimination of an exemption would be unduly disruptive, graduated frameworks offer a middle path. Rather than a binary cutoff – fully exempt below the threshold, fully subject to the law above it – lawmakers could phase-in obligations as firms grow, with the steepest requirements reserved for the largest players.

Once again, tax policy offers a template. The federal income tax is progressive: taxpayers move through multiple brackets as income rises. In some areas, regulatory obligations could follow the same framework. Such a structure would preserve relief for genuinely small enterprises while reducing the perverse incentive to stay artificially small just to avoid crossing a daunting threshold.

For laws aimed at negative externalities like pollution, a third option is particularly attractive: allow firms to choose between (a) complying with the applicable standard and (b) paying a fee calibrated to the actual social harm their noncompliance causes. This approach preserves the incentive for firms to internalize costs that make such regulations valuable while accommodating the genuine variation in compliance costs across firms of different sizes.

THE RHETORIC PROBLEM

Alongside these structural reforms, there is one simpler change that the debate over small-business policy needs: honest rhetoric.

Politicians who advocate for small-business preferences routinely invoke images of the small-town grocer, the neighborhood restaurant, the family farm. These images are emotionally resonant and politically effective. They can also be misleading. When the governing definition of "small business" encompasses firms with $47 million in revenue or 1,500 employees, political rhetoric does not reflect reality. Public support for these provisions almost always rests in part on a misunderstanding of who actually benefits from them.

There are two potential responses to this disconnect. One is to change eligibility thresholds so that they do actually correspond to the kinds of enterprises politicians invoke when making the case for special treatment. The other is to be straightforward with the public about the fact that many beneficiaries are not Main Street storefronts and the like – and then to make the affirmative case for why such firms still deserve preferential treatment. What is not defensible is continuing to justify policies that benefit firms with hundreds of employees or tens of millions of dollars in revenue by pointing to "the barber shop with the first dollar bill still taped to the wall."

* * *

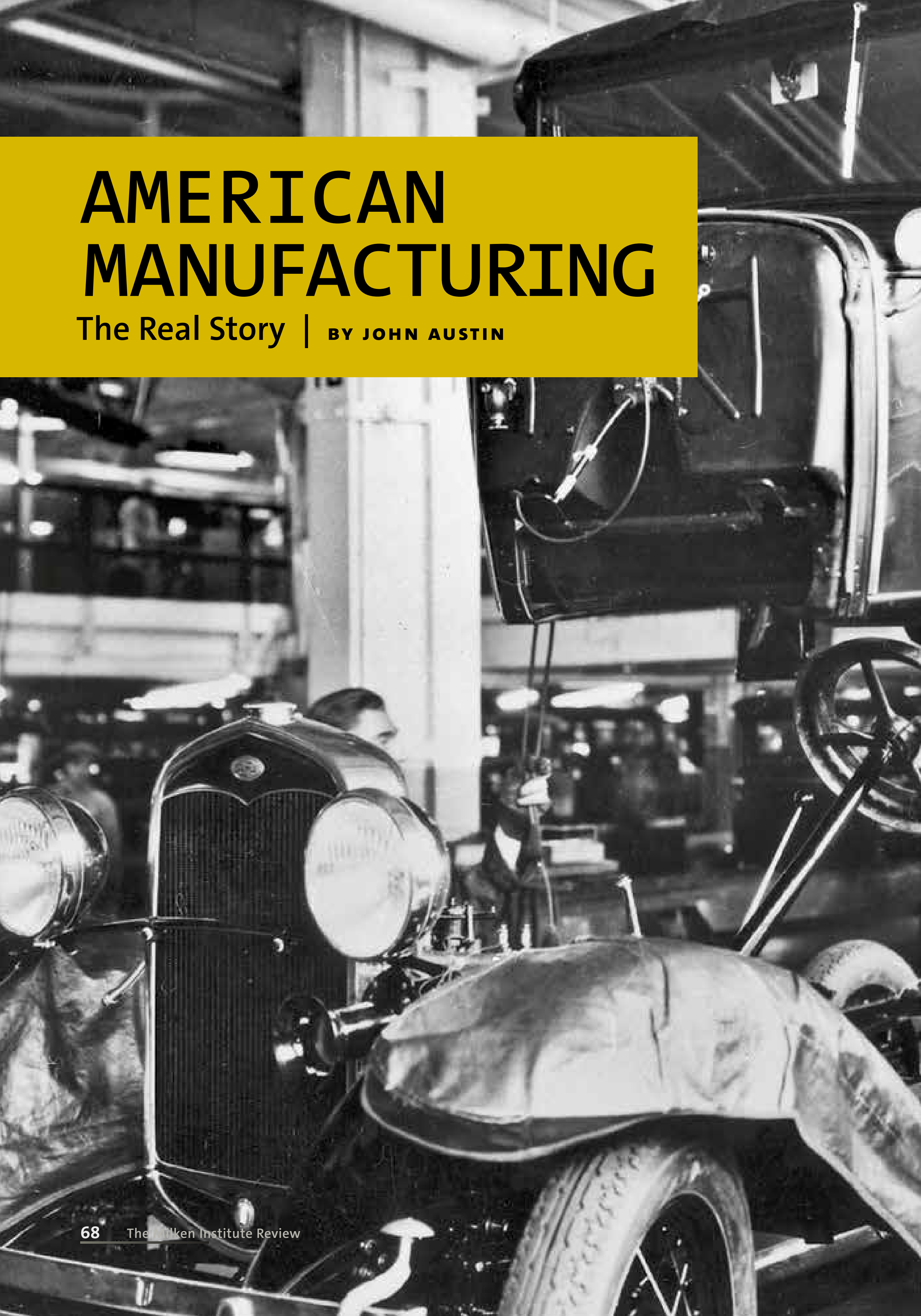
Small businesses occupy a hallowed place in American civic culture. They represent entrepreneurial ambition, community rootedness and the possibility of building something from nothing through hard work and ingenuity. That image has translated into an extensive but largely invisible system of legal privilege available to firms far larger than any plausible sense of "small."

The rationale for this system is questionable. The costs of small-firm favoritism in terms of diluted societal protections, inefficiently allocated public resources, procedural burdens on agencies, and incentives for firms to stay small are real and substantial. The purported benefits – job creation, innovation, leveling a tilted playing field – are harder to pin down.

To be clear, this analysis does not support wholesale elimination of every small-business preference on the books. But it does suggest that this legal regime is due for an audit, a rigorous review of whether each provision is actually doing what its proponents claim at a cost to the public that is worth bearing.

AMERICAN MANUFACTURING

The Real Story | BY JOHN AUSTIN



A conventional wisdom that cuts across contemporary ideological lines is that American manufacturing, long the engine of American prosperity, has been laid low by a combination of globalization, indifference to the plight of workers and unfair foreign competition. In fact, U.S. manufacturing has never been more productive or yielded more output. And while rapid changes in technology, global competition and the declining power of organized labor have undermined the economic stability of less-skilled labor – and entire regions – efforts to turn back the clock are an economic (if not political) dead end. Indeed, to understand what's happened and what should be done to repair the very real damage requires some historical perspective.

A CAPSULE HISTORY

An underappreciated fact: the industries that powered the United States' rise in the 20th century, and in turn revolutionized the economies of the world, were born in the Midwest heartland. This cradle of America's industrial economy, where the oil, aviation, steel, machine tool, consumer durable goods and processed foods industries germinated, also spawned assembly-line manufacturing that ushered in global mass production.

These industries – and autos in particular – sparked the growth of great cities across the upper Midwest and Great Lakes region along with an interdependent network of smaller factory towns sprinkled liberally amidst the region's cornfields and forests. A highly integrated supply chain providing the inputs of everything from farm machinery to chemicals to pharmaceuticals grew up, stretching from Minnesota through the Great Lakes to West Virginia.

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Come the middle of the 20th century and the collapse of war-devastated foreign competitors, U.S. manufacturers, led by giants like Flint, Michigan-born General Motors and Pittsburgh-based U.S. Steel, presided over the economic reconstruction of Europe. But then they had no competition for more than a decade and enjoyed the easy pickings from pent-up post-war domestic demand. As a result, the entrepreneurs who launched these manufacturing empires saw their progeny grow complacent and lose their zeal for quality. Though still churning out lots of product, by the 1970s much of the Midwest's mighty manufacturing base had degenerated into what self-styled "shoprat" Ben Hamper in Flint called "assembly line anarchy."

As Hamper wrote in his 1991 book *Rivethead: Tales from the Assembly Line* – life on the assembly line in post-war "heydays" at GM's Flint Truck and Bus plant was all about fighting boredom and enduring repetitive tasks with the aid of booze secreted among car parts, along with "doubling up" on jobs to cover for co-workers taking off for their cottages "up-North" or for Mark's Lounge across the street.

Then the idyll broke. Manufacturing economies in Europe and Asia reemerged, built around quality control and process efficiency and aided by revolutions in transportation and communications that leveled oceans as market barriers. Complacent American companies were forced into a desperate race for survival.

These new global competitors drove a dra-

PREVIOUS SPREAD: ULLSTEIN BILD/ULLSTEIN BILD VIA GETTY IMAGES matic restructuring of the industrial heartland's heavy industry. Whole sectors pioneered in the U.S., ranging from electronics to automated machine tools, went elsewhere. The giant car assembly complexes like the aforementioned Flint Truck and Bus, were either shuttered or radically transformed to cut costs and improve quality. And in the process, those armies of shoprats were replaced by platoons of technicians. The region saw once-thriving communities bleed residents and manifest signs of decay – all earning the region the pejorative moniker the "Rust Belt."

NOSTALGIA MASKS THE NEW REALITY

When I arrived in Flint in the early '90s to work on economic and community development, GM's local payroll had already dropped from 70,000 to 7,000, and a city built for a quarter million residents was home to less than 100,000. In this environment, memories of assembly-line anomie faded; what remained was nostalgia for the 1950s and '60s – a nostalgia for what seemed to have been a workers' utopia, with good jobs for the taking, crowded schools and playgrounds, well-tended parks, soap-box derbies and packed Friday night high school football.

In communities like Flint, which are today trying to conjure a path toward some form of economic and civic renewal, the deepest lament is the loss of high-paying jobs that don't require much education – jobs that turned out to depend on the splendid isolation of a market in which American manufacturers could profitably sell whatever they wanted to consumers lacking a choice. This same nostalgia informs the pitch made by politicians (including the Trump administration) to residents of the heartland – promises to "bring back manufacturing." Indeed, this is the pledge that undergirds the current tariff regime and the zero-sum-game trade wars that now engulf the world.

But there can be no bringing back this past. As Scott Bernstein, president of Beta Steel Group in Michigan, put it: "Nothing is the same. Got to be better, smarter, faster."

In fact, Bernstein was not to be disappointed. While many manufacturers did resist change (or changed too late), others like the Big Three automakers rallied, investing in quality, restructuring production to cut costs, upskilling workers and diversifying into new processes and higher-value product lines. The mists of nostalgia obscure this dramatic restructuring that has been going on for the past 40-plus years.

> Today, with some exceptions like work in meatpacking (and other jobs native-born Americans increasingly aren't willing to do), manufacturing jobs are both high-paying and high-tech.

Truth is, America never really "lost" manufacturing – it has just radically changed. The value-added by manufacturing output has actually tripled since the mid-1970s recession. But there's no hiding the reality that change came at the cost of social dislocation: of the U.S. total workforce, manufacturing employment has fallen to just 9 percent.

And what of the global market? At 16 percent, the U.S. remains a manufacturing powerhouse, second only to China in its share of global output – a number greater than Japan, Germany and South Korea combined.

Moreover, second place is in many ways better than first: China's industrial workforce is much less productive than its U.S. counterpart. With value-added of over $141,000 per worker, the United States boasts the world's most productive manufacturing industry, beating second place South Korea by over $44,000, and China by a whopping $120,000!

However, more productive labor does not automatically mean better-paid labor. Real wages in U.S. manufacturing as a whole began to decline in the early to mid-1970s, largely reflecting the disappearance of the high-wage, low-skill jobs that had been an artifact of U.S. manufacturing dominance and sheltered markets in the post-war decades.

Today, with some exceptions like work in meatpacking (and other jobs native-born Americans increasingly aren't willing to do), manufacturing jobs are both high-paying and high-tech. The catch: they're scarce and generally require specialized skills. This is reflected in the dramatic shift over the past 20 years in the occupational mix of people working directly in manufacturing. As the economy recovered from the 2007-8 recession, traditional blue-collar production occupations never came back, while knowledge-worker jobs enjoyed big gains.

CATCHING UP

Over the past 70 years, even as once-dominant global manufacturing economies regained their footing, new ones including China, South Korea, Mexico and Vietnam began to play a more important role in what became a wildly competitive sector. A key enabler was the increase in economic interdependence based on materials and parts through an increasingly tightly knit global network. Rather than retreat from globalized production, U.S. manufacturers adapted by tapping the massive efficiencies of cross-border supply chains.

SERGE ATTAL/GETTY IMAGES

While never as isolated as commonly thought, today it is virtually impossible, and certainly would be unprofitable, to sever U.S. manufacturing from the world. For example, smartphones (a U.S. innovation) draw on some 45 countries for components and materials. By the same token, there is no longer any such thing as a U.S.-made automobile – parts often cross in and out of the U.S. some six to eight times before coming together as vehicles ready to drive off the lot.

As a result, tariffs touted by the White

House as a means of protecting U.S. manufacturing from competition have the opposite effect. Much of the cross-border commercial traffic hit by tariffs is comprised of materials, parts and components rather than finished products. Indeed, 2025 data show that intermediate goods constitute an even larger portion of U.S. trade than a decade ago, with approximately half of all goods imported into the United States so classified. These imported components are essential for much of so-called "domestic" production. Intermediate goods also make up a significant portion of exports, with industrial supplies accounting for 38 percent of total exports in 2022.

Advanced economies like the U.S. operate in environments in which manufacturers operate an integrated global "co-production" system, with small competitive edges determining whether individual components are in, say, Mexico, Vietnam or the United States. Indeed, it is best thought of as a co-production system powerfully "machined" by competition to deliver the highest quality at the lowest possible cost, which is possible only because of complex international supply chains. Against this backdrop, any spanners thrown in the works – like tariffs that effectively negate comparative advantage – increase costs for everyone.

New analysis from the Economic Innovation Group shows that the Trump tariffs particularly hurt the competitive position of advanced high-tech manufacturing products – defined as those product lines made by a workforce with double the national share of STEM workers. These are sectors like transportation equipment, computer and electronic products, chemical products, machinery and electrical equipment and components – high-value products that the U.S. Midwest specializes in that can deliver the concomitant high wages U.S. workers expect.

EIG found that manufacturers of these higher tech products depend more on imported materials and components than low-tech, low-wage employers. Chemical and pharmaceutical makers import one-third of their inputs and equipment, while transportation equipment manufacturers import more than one-quarter. Higher tariffs on all these inputs will likely increase costs of their product lines for Americans, making these business' products less competitive in export markets, and hurting these industries' workers and U.S. consumers alike.

Manufacturing nostalgists forget that our great industries were actually internationalized pretty quickly for the same competitive reasons and realities that exist today. Soon after his game-changing introduction of the assembly line in Dearborn and Detroit, auto pioneer Henry Ford moved some production across the river to Windsor, Canada, to serve an expanding market. Ford initially planned to source auto parts locally, keeping small towns healthy and workers on the land with his "Village Industries" program. But he soon realized this would not work and began sourcing materials globally. Looking for cheap, reliable (and non-imbibing) workers, he also sent boats to Yemen to bring back immigrant workers. This ironically proved to be the vanguard of a Middle Eastern diaspora that now defines Southeast Michigan.

HIGH WAGES ONLY COME FROM HIGH-VALUE

At this moment in industrial evolution, what we make and sell has to be high-value and high-quality if it is to generate decent wages. This in turn implies that almost all high-paying jobs require substantial skills. Indeed, a study at Georgetown University's Center on Workforce and the Economy found that 95 percent of all jobs created since the Great Recession required some form of post-high school technical or higher education.

The U.S. and Midwest regions' impressive productivity gains in recent decades – the massive amount of wealth per manufacturing worker that shows up in today's data – reflect the fact that constant competition combined with technological change can keep the manufacturing industry thriving. I recently saw the process first-hand on tour with European economic development officials inspecting the state of play of communities and companies across the industrial Midwest.

We visited now thriving, high-tech Pittsburgh (which has rebounded after its steel industry collapsed in the '70s) as a center of robotics, AI and medical technology. We toured the National Robotics Engineering Center, which is run by Carnegie Mellon University and housed in an old emptied out steel mill. There, researchers told us of their work to automate everything in our lives.

Outside Erie, Pennsylvania, a historic

manufacturing hub that has made products ranging from bicycles to massive locomotives, Penn State undergraduates are developing new products and processes for local plastics manufacturers utilizing 3D printers – and collecting patents. In the process they are preparing to transition to good paying jobs with area employers.

In Youngstown, Ohio, another former steel city rivaling Pittsburgh in its heyday, startups are growing out of the Youngstown Business Incubator, part of a federally funded manufacturing innovation hub. Instead of steel, rising firms are making giant machine tools that spit out custom designed precision parts for defense and aerospace uses.

In Cleveland, where the big players in steel and auto parts imploded, a center for medical science research focused on bioengineering is working on artificial body parts under the umbrella of the Cleveland Clinic and Case Western Reserve University. These devices are of course much more valuable than the molds and sprockets produced nearby in the golden decades of Midwestern industry.

In Grand Rapids, Michigan's legacy furniture makers turn out the highest-tech digitized office environments in the world – equipment befitting the bridge of Star Trek's Enterprise. Among their products: office equipment purchased by the German Ministry of Information Technology.

Columbus, Indiana, is the home of Cummins, the classic Midwest-factory-town anchor employer and engine company. But unlike many Midwest towns with a dominant manufacturing employer, Columbus is more than holding its own: Cummins is booming thanks to its tireless efforts to lead the industry in energy-efficient green technologies.

These examples confirm what specialists have widely concluded: that America does not need a new policy toward manufacturing. Rather, it needs more nuanced intervention that helps businesses to innovate and, in some cases, that protects the broader economy from structural weaknesses that undermine the country's long-term security.

THE PROSPECT FOR CREATING (OR HANGING ONTO) GOOD JOBS

Today there is no shortage of recipes floated for the "rebirth" of manufacturing in America. Tariffs and a new protectionism embodied in the Trump administration's "America First" rhetoric are but one extreme on a continuum. At the other is a new "abundance" agenda in which streamlined regulation and unfettered AI are promised to unleash the gods of growth anew.

> America must revivify a relatively open immigration system that has allowed the best and the brightest to flock to the U.S. – bringing their competitive spirit and creative genius.

But if the real experience of the U.S. manufacturing sector as described here is accurate, neither extreme is on the mark. A pragmatic pro-manufacturing, pro-growth agenda needs to be fashioned from elements that have worked very well for America in the past.

First, give the private sector the leeway to compete on quality and cost in an increasingly interdependent world – and don't try to put globalization back in the bottle. Meanwhile, accept there is a legitimate (but limited) role for government to promote the national interest through intervention in

BILL PUGLIANO/GETTY IMAGES

markets. In particular, government needs to provide "public goods," whose return cannot be fully captured by private actors. These public goods include, for example:

• Basic research

• High-quality universal education, which today means access to tertiary education for all along with upskilling for workers in transition

• Infrastructure that includes high-quality transportation and communication

• Rules of the road that fairly police competition and protect intellectual property

• Efficient environmental regulation, like taxes on pollutants that minimize direct intervention

• Support for open, rules-based international trade

This is a pretty familiar agenda, but one that has sadly been given short shrift in the teeth of interest group politics, myopic populism and geopolitical competition. More than any nation we have excelled at creating disruptive innovations and technologies that periodically transform the economy, creating whole new business sectors and good paying jobs in the process. Henry Ford did it when he pioneered mass production, which was copied around the world. We've done it many times since – think smartphones, GPS and mRNA technology. And we are doing it again now as leaders in AI.

This ongoing innovation process isn't the fruit of an industrial policy, if by industrial policy one means either picking winners or bankrolling a revival of open-hearth steel mills. An effective industrial policy creates a business environment in which the private sector and the market do their thing, with guardrails against market power and negative externalities ranging from pollution to endangerment of workers.

Nurturing this environment for private-sector-led growth has historically been the United States' strong suit. America once led the world in providing advanced education for the masses. Think of the creation of the world's largest network of low-cost public and land grant universities during the 1800s (first built in the states of the heartland), the community college system (first created in Joliet, Illinois, and Dayton, Ohio, to train the workforce demanded by an industrial economy) and programs like the GI Bill.

But sadly, we've scaled back on this monumental effort. In particular, America has evaded its collective responsibility to retrain effectively those who are dislocated by trade and automation.

By the same token, we have begun to question the value of government investments in science and cutting-edge technology. After World War II basic and applied research dollars poured from the federal government, bringing game changers ranging from the transistor to the polio vaccine. Now the Trump administration's populist war on elite universities threatens to throttle the geese that have laid the golden eggs.

Arguably no less important to sustaining our manufacturing competitiveness, America must revivify a relatively open immigration system that has allowed the best and the brightest to flock to the U.S. – bringing their competitive spirit and creative genius. It is no accident that the heights of Silicon Valley are heavily populated by foreign-born founders – or that a disproportionate number of new Main Street businesses in industrial states like Michigan are the work of foreign-born residents.

* * *

This is the real recipe for a striving America and a thriving manufacturing sector that we once animated and that we need to animate again. And contrary to conventional wisdom, government investments that spurred the success of the manufacturing giants did not favor "manufacturing" per se. The most successful government investments, ones that ultimately led to competitive manufacturing, were sector-agnostic.

Look at the two big competitions run under the Biden administration to provide federal funding for non-coastal tech hubs and innovation engines. The winners – many anchored by leading universities across the Midwest and U.S. heartland – are working on advances in, among other fields, quantum computing, advanced materials, energy storage, bioinformatics and advanced sustainable plastics and textiles.

Importantly, these winners are working on innovations of their own imagination and talent – not what the government decides. If there is an element of state direction to these initiatives it is better understood as place-focused policy, bringing economic enablers to the heartland people and places where they are needed the most.

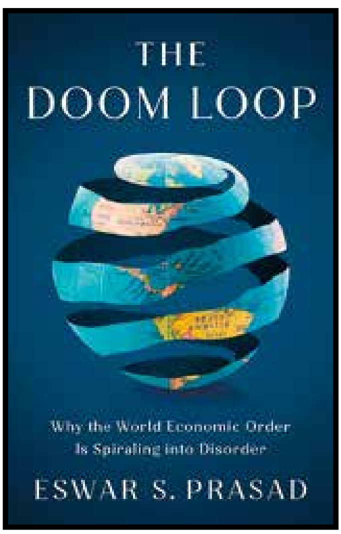
Midwest manufacturing not only survived but has reshaped itself after the dislocation of the 1980s and 1990s, and it has thrived in the decades since the high-water mark for labor-intensive, assembly-line production as seen in Flint's glory days. Yes, there's been a substantial cost to the region and to individual workers associated with this rise from the proverbial ashes. But public support for the affected people and places should start with "do no harm" – not with a wasteful, self-defeating effort to turn back the clock.

Doom Loop:
Why the World Economic Order Is Spiraling into Disorder

BY ESWAR PRASAD
ILLUSTRATIONS BY HUGH SYME

There's no shortage of explanations for why the widely proclaimed end of history and liberal democratic triumph of the 1990s has morphed into an ironic joke a generation later. But the latest, *The Doom Loop: Why The World Economic Order Is Spiraling Into Disorder** by Eswar Prasad, stands out from the pack for a host of reasons. Yes, Prasad does have some pretty nifty establishment credentials: he's a former division chief at the IMF, and holds endowed chairs at both Cornell University and Brookings. But he also brings to the table some unique advantages that distinguish him from the pack. ¶ First, he is a Western-trained analyst (Chicago PhD) who nonetheless empathizes with the perspective of emerging market countries demanding a role in global affairs commensurate with their economic heft. No less important, he is the rare breed of policy wonk who writes really well. ¶ Here, we've excerpted the chapter on the international financial system, which is perilously anchored on the U.S. dollar but isn't about to change. That, suggests Prasad, is probably a better outcome than the alternatives.

— *Peter Passell*



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The U.S. dollar is the most easily recognized, broadly accepted and eagerly desired currency in the world. It is also widely reviled for the power it gives the United States over global affairs.

It is not just U.S. rivals but even the country's allies that chafe at their reliance on the dollar, with the French usually being the most aggrieved of the lot. French Finance Minister Bruno Le Maire pleaded for other European countries to reduce their reliance on the dollar and added, "I want Europe to be a sovereign continent, not a vassal."

In a more expansive speech, French President Emmanuel Macron called for Europe to reduce its dependence on the "extra-territoriality of the U.S. dollar," because otherwise, "if the tensions between the two superpowers heat up … we won't have the time nor the resources to finance our strategic autonomy and we will become vassals."

Clearly serfdom is a mortifying prospect. But not just for the French. Brazilian President Luiz Inácio Lula da Silva railed against the dollar in an impassioned speech before a (needless to say) friendly audience in China: "Who was it that decided that the dollar was the currency after the disappearance of the gold standard?"

Perhaps we are on the cusp of change. After all, emerging-market economies are rivaling the economic and military brawn of the advanced economies. One would expect currency power to follow a similar trajectory. And yet, that has not happened. The emerging-market economies jointly account for roughly one-third of global GDP. Still, currencies like the Indian rupee and the Brazilian real are hardly used outside the countries that issue them.

Even more noteworthy is the concentration of financial power in the hands of one country – the United States. Much of this power comes from the dominance of the dollar in all aspects of international trade and finance, a dominance that has persisted for nearly a century. The U.S. now accounts for only a quarter of global GDP, but the dollar is still by far the leading currency for all aspects of cross-border transactions.

It should not be so. The U.S., after all, sparked the global financial crisis of 2007-9. Its federal government debt is well in excess of a year's worth of GDP, and the political system is dysfunctional. Most important, the U.S. has wielded dollar dominance as a cudgel against its geopolitical rivals with the threat or actual use of financial sanctions.

By all logic, the dollar should have been knocked off its pedestal. Yet, I will argue, the dollar's role in international finance is likely to remain far greater than America's weight in the world economy.

So what if the dollar's prominence has persisted against all odds? Is that fact of any practical consequence? There are, in fact, symbolic as well as practical reasons why the status of a country's currency in international markets matters for economic and geopolitical power. Moreover, the imbalance could potentially add a destabilizing element to a world where economic and military prowess are becoming less concentrated. Washington's willingness to aggressively – and, in the eyes of rivals, recklessly – exploit the dollar's stature contributes to global financial instability and is fracturing financial markets in a way that deepens geopolitical fissures.

We need to begin, though, with a more ru-

dimentary issue, which is how to evaluate a currency's relative importance in global financial markets. Then we will review how and why the dollar remains king and explore why that will not change anytime soon. We will see that, while dollar dominance might prove a saving grace at times of crisis, it is that very dominance which has a destabilizing effect worldwide, for it exposes other countries to the mercurial policies of the United States.

Although it seems logical that more evenly balanced currency competition would promote stability, that conventional wisdom collapses in the absence of other currencies backed by strong financial markets and institutions. Thus, in a curious twist, the preeminence of the dollar confers upon the U.S. the power to rescue the world when a crisis erupts – but that power has itself become the source of worldwide turbulence.

CURRENCY DOMINANCE

The functions of money are often classified into three categories: as a unit of account for transactions, as a medium of exchange for payments and as a store of value over time. The dollar is by far the dominant currency in all three respects.

Trade between countries is denominated in dollars to a far greater extent than in any other currency. The dollar is the leading payment currency as well: by some measures, roughly half of international payments are settled in dollars. When China imports iron ore and soybeans from Brazil, or Brazil purchases semiconductor devices and telephones from China, most of that trade is invoiced and paid for in dollars rather than in Brazilian reals or RMB.

The dollar is not the only currency that plays a role as a "vehicle currency"; the euro accounts for about one-fifth of international payments. However, once you subtract the share of payments made within the eurozone, the euro's share becomes smaller, while the dollar's share is close to 60 percent.

Foreign exchange reserves are typically invested in relatively stable currencies that enjoy worldwide acceptance. Reserves can help ensure a steady stream of imports, even when a country's domestic currency is falling in value and foreign exporters are loath to accept it as payment. Reserves can also be used to pay back foreign investors, making them less likely to dump their investments.

Foreign exchange reserves must be kept in assets that are perceived as safe and are also liquid. The size and liquidity of U.S. government bond market has for a number of years made the dollar the reserve currency of choice.

The dollar is also a key funding currency in global debt markets. When firms or governments in developing countries borrow in foreign currencies, usually because foreign investors lack confidence in the value of those countries' domestic currencies, they tend to do so in dollars. About two-thirds of debt securities issued by corporations outside their home countries are in dollars.

These features reinforce each other. Foreign central bank demand for U.S. Treasury securities helps finance U.S. government borrowing. This keeps U.S. interest rates lower than they would otherwise be, making it attractive for foreigners to borrow in dollars. The widespread use of dollars in international trade gives developing countries an incentive to hold reserves in dollars to facilitate a steady stream of imports even when foreign finance dries up.

The Fed's willingness to support the world's demand for dollars has bolstered the currency's prominence. To meet a surge in demand for dollars during the global financial crisis, the Fed gave a select group of major central banks access to dollar swap lines, which meant they could borrow dollars using their own currencies as collateral. Even the Bank of England and the European Central Bank have had to borrow dollars on behalf of their commercial banks and corporations, which had taken out cheap dollar loans and needed dollars to repay them. The extensive use of these swap lines highlights the continued reliance of other reserve-currency economies on dollar funding.

During the Covid-induced global recession, the Fed gave most countries access to dollar financing using their holdings of U.S. Treasury securities as collateral. This canny move allowed the Fed to provide a large group of countries, including those such as India that had previously been unable to secure swap lines, access to dollars at minimal risk to itself. The Fed's apparent magnanimity gives central banks around the world a stronger incentive to hold their reserves in dollars, pulling them even more firmly into the clutches of the dollar.

We've established that the dollar is the dominant international currency. Does this have any practical consequences for the United States and the rest of the world? Dollar dominance confers many advantages on the United States, although there are some costs as well. For the rest of the world, there are mostly only downsides.

THE MIXED BLESSING

Christmas is an important time of year for retailers in many countries. In the U.S., some retailers earn a disproportionately high share of their annual revenues between Thanksgiving and Christmas. Shopkeepers have to order their wares months in advance, not knowing how strong demand will be or whether their products will be in fashion by the time they hit the shelves. For exporters and importers there is another variable to contend with: the exchange rate of their domestic currency.

Exporters whose revenues are denominated in a foreign currency must convert those revenues to pay workers and suppliers. The exchange rate between the domestic and foreign currencies could change between the time they send an invoice and receive payment. If the domestic currency were to depreciate, they would receive a larger amount of domestic currency than anticipated. But if the domestic currency appreciated, profits might disappear. Importers face similar risk: if a domestic currency depreciated before goods were delivered and payment had to be made, the bill for the goods would be higher.

What if a country's international trade were invoiced in its own currency, with payments also settled in the currency? That is the lucky circumstance for the U.S.: American importers might not know whether the clothes they stocked for Christmas will be in vogue, but at least they won't have to worry about the added risk of exchange rate fluctuations.

There are ways to mitigate currency risk – for a price, of course. But U.S. exporters and importers typically don't have to worry much about this risk or the costs of mitigating it.

This has led some countries to actively discourage the world from becoming enamored with their currencies.

A dominant currency is not always a boon, though. Greater demand for a currency usually reflects confidence in a country's policies and economy, which can drive its exchange rate higher than it would otherwise be. Appreciation usually makes imports cheaper. Dollar appreciation is thus good for American consumers, but makes it harder for domestic manufacturers to compete. By the same token, exchange rate appreciation makes a country's exports more expensive in foreign markets.

This has led some countries to actively discourage the world from becoming enamored with their currencies. From the late 1960s through the early 1980s, West Germany attempted to restrict purchases of deutsche mark–denominated assets by foreign investors. The Japanese showed a similar reluctance to having the yen regarded as a major global currency.

Despite their efforts, the share of the deutsche mark in global foreign exchange reserves rose from 6 percent in the mid-1970s to 16 percent at the end of the 1980s, while the share of the Japanese yen rose from barely 1 percent to about 8 percent. The shares would likely have risen even further if the countries had welcomed foreign money rather than discouraging it.

A well-regarded currency carries other risks. Over the past five decades, the dollar's strength has allowed the U.S. to buy more from other countries than it sells to them, with this difference – the trade deficit – being financed by borrowing from the rest of the world. If the United States continues borrowing to finance its purchases, it could become increasingly vulnerable to a shift in sentiment that causes foreign investors to want to switch out of dollar assets.

While the dollar's prominence is hardly the root cause of indebtedness, it often leads to debt distress for poor countries.

Falling confidence in the dollar would force the U.S. government to pay higher interest rates on the debt that it issues to finance its budget deficits, soaking up a greater proportion of tax revenues. This could also cause the dollar's value to plunge relative to other currencies, raising the price of imports.

That this has not happened despite decades of large U.S. trade deficits is surprising. What is even more surprising is that there are several reasons the day when the United States is held to account for its spendthrift ways (if it ever arrives) might be well in the distant future.

Much of the world regards the dollar's dominance as undesirable, with good reason. The intermediation of so much trade and finance through the dollar leaves other countries, especially smaller and developing ones, at the mercy of the dollar and the whims of U.S. policies.

Fluctuations in the dollar's value and actions taken by the Fed affect other economies, occasionally in damaging ways. For instance, when the Fed cuts interest rates to prop up the U.S. economy, money often flows out of U.S. financial markets into fast-growing emerging markets in search of better returns, causing their exchange rates to appreciate and hurting their exports. On the flip side, when the dollar appreciates against other currencies, perhaps because the Fed has raised interest rates to control inflation at home, capital tends to flow out of those economies.

To the chagrin of policymakers around the world, the Fed takes account mainly of domestic factors when making its policy decisions. It largely ignores the effects on other countries, as doing so is not part of its official mandate.

The dollar remains by far the world's deepest and most liquid financing currency, making it easy to raise large amounts of dollar funding relatively cheaply. The temptation of cheap dollar funding has been difficult for foreign governments and corporations to resist. For their part, investors worldwide are usually eager to provide dollar funding because the dollar's traditional strength and the Fed's apparent willingness to provide dollars in copious quantities in times of stress reduce the risks of such lending.

But because such lending is carried out in dollars, the risks associated with exchange rate fluctuations fall entirely on the borrowing corporations and countries. Thus, while the dollar's prominence is hardly the root cause of indebtedness, it often leads to debt distress for poor countries.

All things considered, the world seems eager to reduce its dependence on the dollar. Even most Americans might view its dominance as a mixed blessing. So why hasn't the dollar tumbled from its exalted perch?

THE PERPLEXING PERSISTENCE OF DOLLAR DOMINANCE

The value of a currency depends on the confidence people place in it. Yet the present state of the U.S. economy, banking system and policymaking process hardly inspires confidence.

One of the greatest concerns over the dollar's prospects is the sheer level of U.S. government debt. Gross federal public debt at the end of 2024 stood at $36 trillion, roughly 125 percent of annual GDP. Still, Washington seems reluctant to address the annual deficits that continue to add to the debt.

Perhaps the dollar's special status means that the usual constraints do not apply. Advocates of the so-called modern monetary theory (MMT) have argued that the United States should take full advantage of the singular power it has to print money to finance government expenditures. This proposition is as tempting as it is dangerous because it risks legitimizing ever-rising budget deficits.

For all the opprobrium from economists – MMT is neither modern nor a theory, let alone a coherent monetary theory – it is striking that the United States has, in effect, followed this approach for many decades. This hardly means the U.S. economy is exempt from the basic laws of economics – the surge in government expenditures and corresponding deficits in response to the pandemic-induced recession did contribute to a spike in inflation in 2022 – but it is clearly on a much longer leash than other economies.

Ratings agencies pass judgment on the relative safety of debt securities based on a variety of financial indicators. Government securities are typically considered safer than those issued by corporations, although the bonds issued by some countries, including Argentina, Bolivia, Mozambique and Pakistan, to name a few, are certainly worthy of junk status – meaning they are highly likely to default.

In August 2011, one of the three major global rating agencies, Standard and Poor's, reduced the U.S. government's credit rating by a notch, from AAA to AA+, marking the first time the world's safest issuer of debt was downgraded. This was a stunning move, for the very prospect of a default on U.S. government debt had long been considered unthinkable. In short, a U.S. government debt default would be a cataclysmic event with unpredictable but probably dramatic fallout for U.S. and global financial markets.

Such a scenario became no longer unthinkable, however, because the Republican Party realized the threat of forcing a default would provide leverage in negotiations to advance their policy priorities. After all, faced with this threat, the Democrats would surely cave in to Republican demands for fear of otherwise setting off turmoil in U.S. financial markets. Inconceivable as it might seem that politicians would want to turn confidence in U.S. government debt into a bargaining chip, that is now the reality.

So far, the prospect of havoc has prompted the U.S. to pull back from the brink each time. But the risk that a small group of politicians might decide that these consequences have been overstated, coupled with the ever-rising debt, has led to further downgrades. In August 2023, another major rating agency, Fitch, downgraded the U.S. government's long-term debt rating from AAA to AA+.

It is extraordinary for what is widely perceived as the safest asset in the world to be rated as less than perfectly safe. What is even more extraordinary is the effect the downgrades have had.

Usually, a downgrade prompts investors to unload the security. A downgrade of a government's debt would thus raise the cost of financing its deficits and worsening its fiscal position. The country's currency also usually takes a beating when this happens. This is why governments (and corporations) fear the effects of downgrades.

So what happened to U.S. interest rates

after the downgrades? And what of the U.S. dollar? In a word, nothing: the dollar strengthened against most currencies.

One could argue that this was because the downgrades simply ratified what financial market participants had already priced in. Nonetheless, it is remarkable that, unlike any other country, the United States can brush off downgrades with barely any consequence.

While the U.S. has repeatedly pulled back from the edge, it is hard to imagine that such near-doomsdays won't eventually erode confidence in the economy, financial system and currency. Each downgrade conveys little new information, but still reinforces the perception that the dollar's dominance rests on a fragile foundation. Indeed, when Moody's, the third major rating agency, lowered the U.S. government's credit rating in May 2025, long-term interest rates rose and the dollar fell, albeit only moderately and briefly.

Central bank independence is one of the key pillars underpinning a trusted currency. Because central banks are led by unelected technocrats whose decisions affect the economic well-being of a country's citizens, it is a fair question why elected representatives shouldn't have more direct influence over monetary policy. It has come to be widely recognized, though, that leaving a central bank alone renders it most effective. Otherwise, merely the prospect that a central bank could have its arm twisted to print money as a means of funding government deficits can lead to galloping inflation.

Another pillar supporting a global currency is the rule of law, which is especially important for investors. They need confidence that a country's laws will be interpreted consistently and fairly, and that the government will abide by the laws once it has created them. A third pillar is a set of robust checks and balances to ensure that no arm of government can undertake policies that are destructive to a country's interests.

All the traditional reserve-currency economies (including the eurozone, Japan and the United Kingdom) boast such an institutional framework. In the United States, though, each of these pillars came under attack during the first Trump administration. Unhappy with the Fed's policy decisions on interest rates, Trump excoriated the institution as "pathetic," filled with "boneheads," and an "enemy" of the country.

His nominees for the Fed's board of governors included a political hack or two and economists who favored gutting the Fed's regulation of banks. One nominee, Judy Shelton, was a longtime Fed critic who had advocated for reverting to the failed experiment of tying the dollar's value to the price of gold. Her nomination missed Senate approval by the narrowest of margins, with two Republican senators unable to vote because they were quarantining after being exposed to Covid-19.

Thus did the guarantor of the dollar's stable value, the Fed, come to have its independence and credibility threatened by the president of the United States. Not only was the central bank's independence threatened, but a president willing to openly flout laws exposed the limits of the judicial system. And Congress proved unwilling to challenge even Trump's most egregious behavior.

These patterns were reinforced in Trump's second term. Trump has made it clear that his selection of appointees to the Fed's board will put more weight on personal loyalty to him and his policies than on technical competence. Moreover, his administration has undercut the rule of law and further enervated checks and balances.

The apparent shakiness of the American institutional framework should, by all logic, cause the pedestal on which the U.S. dollar has long perched to wobble. But it is not just Republican administrations and weaker domestic institutions that ought to be contributing to such wobbling. Technology could play a role, too.

The dollar's role as an international payment currency is likely to be affected by new payment systems. One prominent example is China's Cross-Border Interbank Payment System (CIPS), which enables direct links with other countries' payment systems. India, Russia and other emerging-market countries are developing their own payment systems that can be connected to CIPS. China and India, for instance, will no longer need to exchange their respective currencies for U.S. dollars to conduct trade.

Such developments could eventually chip away at the dollar's dominance. At the same time, these changes could undermine the roles of other international currencies, such as the euro and the yen, thus weakening the dollar's closest rivals even further.

The United States has wielded the dollar's dominance as a powerful geopolitical tool, often by imposing financial sanctions on its adversaries. The dollar-centric global financial system gives U.S. sanctions particular bite because they affect any country or firm that has dealings with a U.S.-based bank or even a secondary relationship with such institutions. This situation also entangles countries that may not agree with U.S. policies but are forced to follow its lead for fear that their own banks could be cut off from dollar transactions.

In addition to the denomination and settlement of a majority of cross-border transactions in dollars, there is another choke-point in the international financial system. The messaging system that connects commercial banks in different countries, enabling global payments, is managed by SWIFT (the Society for Worldwide Interbank Financial Telecommunication). Headquartered in Belgium and owned by the banks that use its services, SWIFT is in principle nonpartisan and apolitical. But with U.S. banks playing a major role in global finance, the organization is vulnerable to American pressure, especially when other Western economies join in.

This can result in specific institutions being cut off from the messaging system, and when applied broadly, it can cripple an entire country's access to international finance. The U.S. Treasury has deployed these tools in sanctions imposed on the central banks and political figures of many nations it considers rogue, including Iran, North Korea, Syria and Venezuela.

The apparent shakiness of the American institutional framework should cause the pedestal on which the U.S. dollar has long perched to wobble.

Russia's annexation of Crimea in 2014, followed by its invasion of Ukraine in 2022, have made it the most significant target of financial sanctions imposed by the United States and its Western allies. Russia was cut off from the international payment system when most of its major banks lost access to SWIFT. Selective sanctions were also imposed on a few individuals and firms in other countries, including China, Türkiye and the UAE, that were deemed to have helped Russia evade payment restrictions.

Sanctions had in the past affected mainly cross-border payments. But now even foreign exchange reserves have become targets. Thanks to its massive oil export revenues, in the early 2000s Russia had accumulated a war chest of foreign exchange mostly in dollars, euros, pounds sterling, and RMB – precisely to protect the ruble's value during economic or geopolitical turmoil. The freezing of the Russian central bank's accounts in Western financial capitals in response to Russia's invasion of Ukraine effectively sealed a big portion of this war chest.

China certainly helped soften the blow by offering various forms of financial support. But the support was in the form of RMB. Because the RMB is not yet a fully convertible currency, which means the Chinese government restricts how much of it is available and how freely it can be transacted outside the country, its use in global markets is inherently limited. While it might help Russia evade sanctions, China's relatively modest footprint in global financial markets and the vulnerability of Chinese firms and financial institutions to secondary sanctions limit the viability of this escape route.

Russia, China, and other U.S. rivals are certainly motivated to reduce their dependence on the dollar-centric financial system. China's CIPS already has messaging capabilities that could sideline SWIFT. The dollar-dominated global financial system and American influence over SWIFT have long given U.S. financial sanctions substantial traction. The efficacy of such sanctions will inevitably erode over time.

Restrictions on transactions involving Russia's central bank could just as easily be applied against other countries. This should encourage not just Russia but other countries, particularly U.S. rivals, to shift their reserves out of dollars and into the currencies of friendlier countries like China. But, as Russia has discovered, the limited worldwide acceptability of RMB-denominated reserves means that, at crunch time, they are of limited help in preventing the collapse of its own currency. Still, the restrictions on Russia's access to the Western-dominated global financial system will undoubtedly drive it into a deeper economic embrace with China.

Even if the United States were a paragon of sound macroeconomic policies, well-functioning government and robust institutions, the dollar ought to become less dominant over time. Financial markets, including in some emerging-market economies, are becoming more developed, creating a broader pool of assets for central banks to use in parking their reserves. From a diversification perspective, it makes little sense for any central bank to hold more than half its portfolio in a single asset or currency. The high degree of concentration in dollar-denominated reserves – the equivalent of an investor's devoting more than half their portfolio to one company's shares – is risky. When it comes to reserves, the risk is both economic and geopolitical, as we saw in the case of Russia.

Emerging-market central banks hold nearly $6 trillion in foreign exchange reserves (as of late 2024), with China accounting for about half. Managers of those reserve funds, particularly China's central bank, are certainly eager to diversify away from countries and currencies perceived as being on the other side of deepening geopolitical fissures. The difficult reality reserve managers face, however, is that the supply of financial assets that are easy to buy and sell cheaply and in large quantities (and are backed up by strong central banks and regulatory frameworks) primarily comes from large, advanced economies. And even in this small group, the U.S. dollar continues to stand above the rest.

In a world where logic held greater sway, concerns about the dollar's safety, stability and long-term value would increase borrowing costs for the U.S. government and make it harder to finance large budget and trade deficits. Many of the problems discussed earlier mean that the United States is in fact

increasing its share of the supply of "safe assets," which investors around the world are happy to lap up. In yet another irony, it is precisely U.S. fiscal recklessness that enables its bond markets to tower over the rest, with the market value of outstanding U.S. government bonds exceeding those of the eurozone, Japan and the UK combined. China's government bond market is large, but its bonds lack some key characteristics – such as easy access and tradability for foreign investors – that are typical of those in advanced economies.

Still, this picture seems discordant. American politics and policies are undercutting the foundations of the dollar. Moreover, there is clear enthusiasm for ending its dominance. In the international marketplace, only a handful of major currencies still matter. So why haven't any of them assumed the mantle?

FEEBLE ALTERNATIVES

After its creation in 1999, the euro was seen as the main rival to the dollar. The euro area's GDP matched that of the United States, and its financial markets and institutions were seen as robust. Within a few years of its creation, the euro's share of global foreign exchange reserve holdings had risen by about 7 percentage points, the dollar's share had fallen by a corresponding amount, and the writing seemed to be on the wall. But as with many projections of present trends into the future, the prognostications proved wildly off the mark.

The euro's share of global foreign exchange reserves reached 28 percent in 2009. But the global financial crisis, followed by the eurozone debt crisis, put paid to the euro's rise. It became apparent that the zone's financial markets were not fully unified, creating hindrances even to moving money across banks within the zone.

The United States, by contrast, has one financial system, making it much easier to conduct dollar-based transactions. Moreover, the supply of eurozone government bonds that could be considered safe assets is smaller than suggested by the overall size of the government bond markets of the member countries. The illusion that a Greek or Italian government bond carries the same level of risk as a German government bond is no longer tenable. The eurozone continues to be riven by economic malaise and political dissension, with centrifugal forces constantly straining its unifying fabric. So the euro's prospects as a serious rival to the dollar have faded.

Surely the second-largest economy in the world should have a currency that matches its heft on the global stage. Spurred by this ambition, in 2010 the Chinese government and central bank initiated a project to promote the "internationalization" of the RMB. The government committed to reducing restrictions on financial flows into and out of the country, limiting its control of the RMB's exchange rate relative to the dollar, and giving foreign investors easier access to China's equity and bond markets.

These promises paid off. In October 2015, IMF officially designated the RMB an elite reserve currency by announcing that, within one year, it would be included in the small "basket" of currencies that determine the value of the IMF's own currency unit, the special drawing right. The SDR is a composite currency created out of thin air by the IMF and distributed to all its member countries. From 1999 to 2015, the SDR basket included the dollar, euro, Japanese yen and British pound sterling. The RMB's addition was symbolically momentous both for China and the international financial system, the first time an emerging-market currency was put on par with major advanced-economy currencies.

Meanwhile, China's central bank, the People's Bank of China, signed agreements with a number of central banks providing them with easy access to each other's currencies – much like the Fed's currency swap arrangements. The Fed limits its arrangements to a handful of select central banks. But the People's Bank of China was far more inclusive, signing agreements with more than 30 counterparts including the central banks of many developing countries. The point was to encourage those central banks to view the RMB as a viable international currency that would be readily available to them to borrow in time of need.

From 2010 to 2015, the RMB indeed made significant progress to becoming an international currency. It went from accounting for virtually no cross-border payments to being used in nearly 3 percent of such payments. Even this modest share meant the RMB had become the fourth or fifth most important payment currency in a remarkably short period. Predictions placing the RMB on an unstoppable path to shattering the dollar's dominance began bubbling up.

Then reality hit. In August 2015, the People's Bank of China set off turmoil in currency markets by devaluing the RMB by about 2 percent relative to the dollar, a move meant to support the country's exports.

The timing was particularly inopportune as the Chinese economy was stalling and the government was in the midst of an anticorruption campaign. With wealthy Chinese worried about the safety of their fortunes and with foreign investors souring on the country's stock markets, money fled the country. The government curbed capital outflows and still ended up spending about a trillion dollars of its foreign exchange reserves (which, at their peak, amounted to $4 trillion) to support the RMB and prevent it from collapsing in value against the dollar.

These events reflected China's violations of its commitments to reduce restrictions on cross-border financial flows and to allow market forces to determine the exchange rate of the RMB. Despite this turmoil, the IMF went ahead with its decision to include the RMB in the SDR basket. But the rise of the RMB had fizzled by then, and the illusion that it was one of the elite global currencies had been shattered.

The RMB is still likely to make further progress as an invoicing and payment currency reflecting China's large role in global goods trade. Access to RMB is useful for countries that have formed strong trade and financial linkages with China, and such access could become increasingly attractive as the RMB gradually rises in stature. The RMB's share in emerging-market economies' reserve holdings will grow driven by efforts to diversify those holdings and by geopolitical tensions, although this increase will be constrained by China's capital controls and weak institutional framework.

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But the RMB will not become a significant reserve currency until China allows its financial markets to develop more freely and subjects those markets to effective regulations that enable foreign investors to easily trade high-quality RMB-denominated assets. The currency's role in global finance will thus ultimately be determined by the degree of commitment on the part of Xi Jinping's government to economic and financial market reforms.

Barry Eichengreen of the University of California has highlighted the rise during the 2010s and early 2020s in the shares of smaller currencies in foreign exchange reserve portfolios. Collectively, their share in global reserve portfolios was about 11 percent in 2025 compared with 2 percent in 2000. The Australian and Canadian dollars, the leaders of this motley pack, each now accounts for 2-3 percent of global payments and reserves.

None of these currencies amounts to much by itself, though, and the increase in their collective shares merely points to a desperate worldwide desire for currency diversification. Ironically, while the U.S. dollar's position as the dominant international currency may erode modestly as part of this realignment, the larger effects appear to be on the second-tier currencies such as the yen and the pound sterling. The importance of these once-powerful currencies has declined in recent years, both in payments and in foreign exchange reserves.

Hope springs eternal, and some of those eager for a switch out of the dollar have pinned theirs on the IMF's Special Drawing Rights.

Occasional proposals to combine the financial firepower of multiple countries to create a stronger currency are attractive but ultimately unrealistic. China, Brazil and Russia – three of the five countries that comprise the BRICS group – would dearly love to disengage from the U.S. dollar. Even India and South Africa, the other two in the group, would no doubt prefer a world in which they are less vulnerable to the whimsies of Fed policies. So this group has talked up the possibility of creating a common currency, based on the notion that their collective economic might and prominence in trade should give such a currency immediate traction if they agreed to use it among themselves.

Questions about who would issue and manage the currency might prove too challenging, though, for a group with some common aims but little mutual trust. A BRICS currency will, in any event, remain a mirage until the countries involved can strengthen their financial markets and regulatory structures, and, most importantly, enhance their institutional frameworks.

Gold has long been an alluring asset. Its limited supply has resulted in an article of faith among many investors and even some central banks that it will hold its value well over the longer term. Gold has certainly been around as a store of value for centuries if not millennia, far predating any of the official currencies issued by a national central bank now in circulation.

Similarly, the cryptocurrency bitcoin is scarce in supply, and proponents view that as the underpinning of its value as a financial asset. A specific number of bitcoins is created roughly every 10 minutes, and this number is programmed to decline over time, ultimately capping the number of bitcoins at 21 million. Bitcoin has no intrinsic worth, as it has not proven to be a trusted medium of exchange for transactions because of its volatile value. Nevertheless, this original cryptocurrency has become what it was never intended to be – a financial asset.

Neither gold nor bitcoin is a viable alternative to the dollar as a payment or invoicing currency due to their unstable values and limited supply. Their suitability as reserve assets is constrained by these same limitations, as well as their lack of liquidity. Imagine what would happen if a central bank tried to sell tens of billions of dollars' worth of gold or bitcoin in a short period. Prices would tank, and the seller would soon be selling into a sinking market.

Perhaps one way to keep the dollar central to global finance while erasing some of the undesirable side effects of its dominance is to link its value to gold. The idea of backing dollars with something that is scarce and whose supply cannot easily be expanded seems appealing. Pinning its value to what is in effect a purely speculative financial asset, however, is hardly a sensible path to monetary and financial stability.

There is a good reason why the backing of the dollar and other currencies by gold was abandoned many decades ago: it severely constrains monetary policy and restricts exchange rate fluctuations, depriving countries of tools to stabilize their economies in response to changing circumstances. Adherence to the gold standard contributed to the Great Depression of the 1930s by limiting the increase of money supply that could have stimulated growth. Reverting to a gold standard remains a misguided and dangerous idea in the worlds of modern money and finance, where such constraints could severely limit central banks' capacity to guide economic activity and maintain financial stability by using interest rates to influence credit creation.

Hope springs eternal, and some of those eager for a switch out of the dollar have pinned theirs on the IMF's Special Drawing Rights. The IMF itself emphasizes that the SDR is not a typical currency, however. It cannot be used directly in private transactions. The IMF describes the SDR as "a potential claim on the freely usable currencies of IMF members."

In simpler terms, SDRs can be used as collateral by national governments to borrow real money, such as dollars and euros, that they can use to purchase imports or pay off creditors. Inasmuch as the IMF is a trusted institution and can create as many SDRs as its members will allow it to, this seems a simple solution for a globally accepted currency to supplant the dollar. The IMF would just credit countries' accounts at the institution with newly minted SDRs.

In fact, emerging-market policymakers are wary that IMF money might come with strings such as requiring them to undertake painful economic reforms or agree to meet labor and environmental standards. Moreover, with voting power at the institution largely in the hands of Western economies, countries on the other side of the geopolitical divide can hardly count on unfettered access to money from the IMF, even if it sits in their own accounts at the institution.

There are also economic reasons why the IMF cannot supply large quantities of SDRs without affecting their relative value. Every central bank is protected by the taxing authority of the national government behind it. That authority takes the form of the government's insistence that tax obligations be paid using only money issued by the country's central bank.

This requirement generally helps protect the relevance and value of central bank money unless the government runs large budget deficits. The IMF has no such backing; it relies on the goodwill of its member countries to provide their currencies in exchange for SDRs when needed. And the system of checks and balances that anchor the values of major national currencies is absent, so the SDR could face a crisis of trust during difficult times. Thus, for all its virtues, the SDR is not destined to become a rival to the dollar.

WHY THE DOLLAR WILL REMAIN DOMINANT

It is becoming ever harder to view the United States as a well-functioning, dynamic economy with a deep and sound financial system backed by a robust policymaking process with checks and balances. For all the country's strengths, its economic and financial woes will ultimately take a toll on U.S. economic and geopolitical leadership. Still, the absence of any viable alternatives to the dollar will put off its day of reckoning well into the future. In fact – and much to the world's consternation – many forces are driving increasing concentration of the dollar's power and growing fragmentation in the power of other currencies.

This currency bipolarity, with one dominant renegade currency on one side and a plethora of other currencies with their own shortcomings on the other, seems a recipe for instability. Could change be imminent?

Dollar doomsayers invariably point to how quickly the dollar replaced the pound sterling as the dominant reserve currency after World War II. The implication is that this could just as easily happen to the dollar. But times are different. The United States has no serious rival that can match its combined economic and financial market size. And although its institutions have frayed, those of other major economies are in worse shape.

There are other quirks that make any drastic change unlikely. In the early 2000s, expectations were rampant that the rest of the world would tire of lending to the United States and that the dollar would collapse. Curiously, the turmoil unleashed by the global financial crisis instead led central banks and other investors to seek safety in the dollar, the currency of the very country that precipitated the crisis!

Foreign investors hold far more value in U.S. financial assets than American investors hold in the rest of the world. By 2014, U.S. foreign liabilities were $32 trillion and U.S. foreign assets amounted to $25 trillion, rendering the United States a net debtor to the tune of $7 trillion. In theory, this should have given the rest of the world power over the dollar: If foreign central banks and other investors had pulled money out of the dollar, the currency would have collapsed.

In my 2014 book, *The Dollar Trap*, I highlighted one crucial point: U.S. liabilities to the rest of the world are denominated in dollars, while its assets are denominated mostly in foreign currencies. So what would happen if the world turned away from the dollar, sending its value plummeting?

From the U.S. perspective, the value of U.S. liabilities to foreigners would not be affected; they would still be worth the same number of dollars (and of course it is the Fed that prints those dollars, making it even easier to repay dollar debts). But U.S.-owned foreign assets would now have a higher value in dollars because each unit of foreign currency would be worth more dollars.

So, in effect, a plunge in the value of the dollar would be a huge financial gift from the rest of the world to the United States!

Recognizing the perilous position they have put themselves in, other countries should have reduced their exposure to the dollar trap. Quite the opposite has happened. By the end of 2024, America's foreign liabilities and assets were $62 trillion and $36 trillion, respectively, almost quadrupling the U.S. net debtor position over the preceding decade. The United States now has the rest of the world in an even tighter chokehold!

This outcome is as clear an indication as any of one of the most remarkable enigmas in international finance. Despite everything the United States has done that should have driven the world away from the dollar, it remains far and away the dominant economic and financial power.

RICKETY CURRENCY CONFIGURATIONS

While the dollar still reigns supreme, changes are afoot that should, in a more rational world, threaten its dominance. Competition between purveyors of once-prominent currencies seeking to maintain their relevance and upstart currencies establishing footholds, at least as regionally important currencies, could fragment the global monetary system. China, India and many other emerging-market countries are encouraging their neighbors and trading partners to use their currencies. The ensuing competition between currencies that are not anchored by strong economies and financial systems has the potential to hinder cross-border transactions and destabilize capital flows because such currencies are vulnerable to sharp swings in confidence.

Now, the world is tiring of U.S. economic and political dysfunctionality, financial fragilities and heavy-handed global engagement. The prospect of the dollar's meeting its comeuppance from some quarter or another is tantalizing for those who despise the power the currency's dominance confers on the United States. But if the dollar was knocked off its pedestal, that might still be cause for worry.

Consider a reprise of the 2008 global financial crisis. In that moment of great peril, the dominance of the dollar and the willingness of the Fed to provide essentially unlimited quantities of funding to financial markets kept a bad situation from worsening. Even other major central banks relied on access to dollars to stabilize their own financial systems. The fact that there was one reliable, widely known and easily available currency, and that it was issued by a central bank that was trusted the world over, meant the world could coordinate its faith in one currency.

In the Trump era, the Fed may struggle to help other countries avert financial catastrophe, as such actions might not align with Trump's narrowly defined view of America's interests. Yet the situation could be even more dire if the dollar were to lose its primacy.

If financial markets were melting down, investors who were trying to figure out which currency was the safest could add volatility, especially when timely and reliable information was difficult to come by. Sharp swings of investor funds into and out of various currencies would become more likely, and therefore more destabilizing. In short, a world marked by fiercer currency competition might be stable in normal times. But fragility would arise during financial panics, as investors switched between currencies without a single anchor to tie themselves to.

While the dollar still reigns supreme, changes are afoot that should, in a more rational world, threaten its dominance.

This is hardly an uplifting story of American exceptionalism; rather it is a melancholy one of frailties in the rest of the world that allow the United States currency to tower over others despite its propensity to create financial havoc in far-flung corners of the world.

To reduce dollar dominance, other countries would have to further develop their financial markets, improve their monetary and fiscal policies, and strengthen their institutions. That is a tall order, especially in countries beset by other problems such as shrinking labor forces, unstable politics and government policies that sap economic dynamism. Given this state of affairs, the end of dollar dominance would be destabilizing as well, just in a different way and under different circumstances.

All told, the dollar's preeminence spells destabilization from every angle, exposing other countries to turbulence but simultaneously stoking fear that moving away from the dollar, especially if it were to happen abruptly, could unleash far greater turmoil. A true doom loop if ever there was one.

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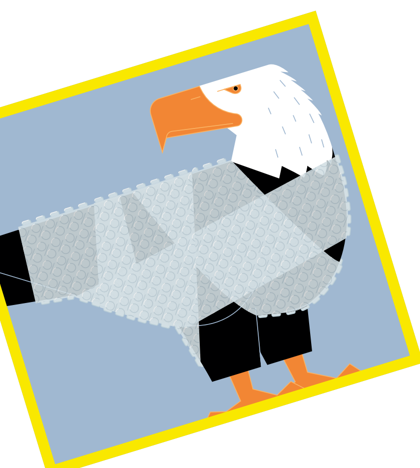

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