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THE CHANGING CONTOUR OF THE GLOBAL CURRENCY RESERVE SYSTEM

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INTRODUCTION

The international reserve currency system is One of the key foundations of international economic regulation; it impacts national policy independence, international trade and payment facilitation, and stability/instability. International currency reserves represent the assets that central banks keep in reserve to hedge against foreign exchange market fluctuations, stabilize domestic currencies during crises, and permit nations to remain solvent to other indebted nations. Furthermore, international currency reserves are the unspoken yet powerful forces of international economic rankings since whatever currency is reserved as the international currency becomes the universal currency of trade, economics, and international relations.

Since the mid-1900s, the US dollar has dominated this system. The Bretton Woods Agreement Post-World War II established the dollar as the linchpin of international monetary transaction, currency linkage to the dollar was standard among other major currencies and the dollar was convertible to gold at a fixed rate. Due to America's enormous economic size, sophisticated and liquid capital markets, comparatively stable legal system, and international confidence in the Federal Reserve's leadership, the dollar remained dominant even after President Richard Nixon broke the dollar's ties to gold at Bretton Woods in 1971¹. For many years, US dollars accounted for more than 70% of global reserves, ensuring stability and unmatched US power.

However, during the first quarter of the twenty-first century, there has been a gradual but discernible change in this system's structure. Despite its continued dominance, the dollar has

¹ Barry Eichengreen, *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*, 07 JSTOR 196 198 (2011).

gradually lost ground, dropping below 60% of allotted reserves². Central banks are expanding their holdings to include euros, yen, renminbi, and even non-fiat assets like gold, especially in emerging markets. At the same time, worries about U.S. fiscal health, the weaponization of financial sanctions, and geopolitical rivalries have hastened the quest for substitutes. Due to growing digital currencies and cross-border settlement schemes, the composition of international reserves in the next few decades will differ significantly from the dollar-dominated arrangement of the postwar period.

HISTORICAL CONTEXT

After World War II, the Allied powers created the Bretton Woods framework in 1944 in an effort to prevent the economic instability of the interwar years, which gave rise to the current reserve currency system. The US dollar was based on gold under this system. The agreement gave the United States exceptional control over global monetary relations and established the dollar as the anchor of the world³. Because the newly established International Monetary Fund (IMF) and World Bank had their headquarters in Washington and functioned primarily under a U.S.-led governance structure, this was not just an issue of economic size by 1945, the United States held three-quarters of the world's gold reserves and accounted for nearly half of global output.

The dollar-gold exchange rate was strained by growing U.S. fiscal deficits, which were initially linked to Cold War military spending and later to the Vietnam War and domestic social programs. U.S. reserves started to be depleted as European nations, especially France, started to demand gold in return for their amassed dollar holdings. The Bretton Woods order was essentially terminated by President Richard Nixon in August 1971 when he suspended dollar convertibility into gold. The implementation of a fiat currency regime, in which markets, not gold, set exchange rates, came next. The dollar continued to dominate even though many people thought it would crash without the gold anchor. The structural reason was that the dollar was ingrained in international trade invoices, U.S. financial markets were extensive and liquid, and U.S. Treasuries were thought to be the safest asset.

The dollar's dominance was all but unchallenged by the end of the twentieth century. By the late 1990s and early 2000s, it made up over 70% of the officially allotted foreign exchange

² Int'l Monetary Fund, *Currency Composition of Official Foreign Exchange Reserves (COFER)* (2024), <https://data.imf.org/regular.aspx>

³ Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* 93–112 (3d ed. 2019).

reserves.⁴ The introduction of the euro in 1999 failed to substantially alter the hierarchy, despite the expectation of some that it would make the dollar a peer competitor. Although the euro quickly grew to account for about 20% of global reserves, the sovereign debt crisis of the 2010s and persistent institutional problems in the Eurozone prevented it from displacing the US dollar. The British pound and Japanese yen, which together made up less than 10% of reserves, were still significant but had a smaller reach. Despite becoming the second-largest economy in the world, the People's Republic of China upheld stringent capital controls, which prevented the renminbi from becoming a broad reserve until it was added to the IMF's Special Drawing Rights (SDR) basket in 2016⁵.

Thus, the U.S. dollar has maintained its market dominance despite major changes to the global currency reserve system since 1944. The dollar has been the primary reserve currency of the world for more than 70 years thanks to its structural advantages of liquidity, trust, and deeply embedded network effects. These factors allowed it to survive the Bretton Woods crisis. However, pressures to diversify have surfaced in recent decades, driven by geopolitics, finance, and technology, and they are progressively changing the system's structure.

IMPORTANCE OF RESERVE SYSTEM

The global currency reserve system is the cornerstone of global financial stability and a tool of geopolitical power, not just a technical tool for controlling exchange rates. Because foreign central banks demand U.S. Treasury securities as safe assets, the dollar's reserve status gives the United States what economists refer to as the "exorbitant privilege," which enables it to finance ongoing current account deficits at comparatively low cost. This privilege offers unmatched fiscal and monetary flexibility and reduces borrowing costs for the United States. It also broadens Washington's geopolitical influence. As evidenced by the sanctions regimes against Iran, Venezuela, and most recently Russia, the federal government can effectively weaponize the dollar by limiting access to its payment systems because the majority of international transactions are processed through financial institutions with ties to the United States⁶.

⁴ Int'l Monetary Fund, *Currency Composition of Official Foreign Exchange Reserves (COFER)* (2002), <https://data.imf.org/regular.aspx> .

⁵ Int'l Monetary Fund, *Review of the Method of Valuation of the SDR* (2016), <https://www.imf.org/en/News/Articles/2016/09/30/AM16-PR16440-IMF-Adds-Chinese-Renminbi-to-SDR-Basket>.

⁶ Daniel McDowell, *Bucking the Buck: US Financial Sanctions and the International Backlash Against the Dollar* 45–53 (2023).

The reserve system has advantages and disadvantages for other nations. On the one hand, owning assets denominated in dollars facilitates international trade, signals macroeconomic credibility, and offers liquidity during emergencies⁷. However, nations that rely too heavily on the dollar are vulnerable to the monetary policy of the United States. Changes in the Federal Reserve's interest rates have an impact on emerging market's capital mobility, credit flows, and currency stability. Therefore, central banks have to strike a careful balance between reducing the risks of concentration and dependence and ensuring safety and liquidity through dollar assets.

The reserve currency structure promotes systemic global stability by providing a widely accepted medium of exchange and store of value. Without such an anchor, cross-border transactions would be more costly, erratic, and unpredictable. However, systemic vulnerabilities are also created by this very centrality. Global markets could become unstable if there is a sudden reallocation away from the dollar or a decline in confidence in it. Therefore, even though the current system has long offered stability, it also confines the world to a framework where the domestic policies of one country the United States can have a significant impact on the global financial order.

CURRENT TREND

The changing shapes of global reserves are illustrated by a number of recent trends. First, a slight increase in other currencies has coincided with the dollar's share decline. Despite its proportion stalling, due to the structural deficiencies of the eurozone, among which its fiscal union remains incomplete, the euro is still solidly in second place as a reserve currency. The Chinese RMB became more prominent since being added to the International Monetary Fund's (IMF) Special Drawing Rights (SDR) basket in 2016, yet barely accounts for less than 3% of the allotted reserves with China's capital control and lack of convertibility carried on⁸.

Second, gold is a considerable part of central bank reserves once more. The 2023–2024 saw a record surge in central bank gold purchases as countries including China, India and Turkey bought more to insulate themselves from geopolitical instability and risk associated with the

⁷ Int'l Monetary Fund, *Holding Foreign Exchange Reserves* (2019), <https://www.imf.org/external/np/sta/cofer/eng/index.htm> .

⁸ Int'l Monetary Fund, *Review of the Method of Valuation of the SDR* (2016), <https://www.imf.org/en/News/Articles/2016/09/30/AM> , 16-PR16440-IMF-Adds-Chinese-Renminbi-to-SDR-Basket

dollar. As the Financial Times recently noted, gold has now, in some respects, supplanted the euro as the world's No.2 reserve asset.

Third, diversification has been sped along by the increased use of sanctions as a foreign policy weapon. After the Russian reserves were frozen, some emerging markets reconsidered whether it was secure to hold US dollar-denominated assets. In the 2025 report, the Federal Reserve points to concerns over political polarization and U.S. fiscal stability as risks that could significantly erode confidence in the dollar's unrivaled position.

Changes in technology are finally starting to have an impact. CBDCs are being tested by central banks, and regional settlement agreements and alternative payment systems like China's Cross-Border Interbank Payment System (CIPS) are gradually growing. These developments, though still in their infancy, offer potential long-term substitutes for the SWIFT system, which is centered on the United States.

THE ROAD AHEAD FOR THE GLOBAL RESERVE SYSTEM

Rather than the dollar is getting essentially dethroned, most believe that there will be more of a multi-polar system in the future. Due to institutional trust, network effects and the extreme liquidity of US Treasury markets, the dollar is likely to remain dominant. However, there will be continued steady diversification with the RMB, gold and potentially digital currencies playing an increasing role. As a reflection of trends in portfolio diversification, the IMF expects nontraditional reserve currencies, such as the Canadian dollar, Australian dollar, and Swiss franc, to continue drawing allocations⁹.

Regionalization is a second likely path, in which blocs like the European Union, ASEAN economies, or the BRICS countries depend more and more on regional currencies for reserves and trade settlement. Instead of a single hegemonic structure, this might split the global reserve system into overlapping spheres.

Digital technology's potential for transformation There is a revolution brewing in the digital technology space. If successful in driving cross-border interoperability, CBDCs could provide more efficient settlement systems and reduce reliance on the dollar. Options to be added at supranational level may also evolve into complements in an official global reserve, such as a

⁹ Int'l Monetary Fund, *Enhancing the Role of SDR in the International Monetary System* (2022), <https://www.imf.org/en/Publications/Policy-Papers/Issues/2022/09/15/Enhancing-the-Role-of-SDR>.

larger role for IMF Special Drawing Rights. Yet because no other currency can rival the dollar's liquidity, security and global reach today, meaningful overhaul will take decades.

CONCLUSION

The world reserve currency system is at an inflection point. For more than 70 years, the dollar has served as the world's dominant reserve currency and today is still used in about 60 percent of international trade; with the consolidation of its dominance by the Bretton Woods system and through its continued life in a post-gold era. The world economy has benefited from its dominance in stability, liquidity and predictability, but today America possesses an unprecedented amount of discretion. New economic, geopolitical and technological realities are testing the structural advantages that long entrenched the dollar as king, such as dominant trust in American institutions, deep and liquid Treasury markets and established network effects.

Such trends make the gradual but undeniable erosion of unipolar hegemony evident. A more fractured and multipolar future is hinted at by the increasing popularity of nontraditional currencies such as the euro and the renminbi, of gold as a reserve asset, and the surge in efforts to develop central bank digital currencies. Increasing (geopolitical) tensions have also renewed interest in diversification, encouraged by geopolitical skirmishes especially the growing use of financial sanctions and restrictions as tools of diplomacy, prompting states to reduce their reliance on U.S.-centric systems. But, developing countries and emerging markets know that resilience requires a nimble reserve portfolio.

However, the change is evolutionary rather than revolutionary. No other currency has anything like the global reach, depth and credibility of the dollar in today's world, so it is unlikely to be completely replaced any time soon. Instead, the system is transitioning to one in which the dollar remains preeminent but there are additional reserve assets including not only gold and regional currencies but also possibly supranational or digital alternatives. In so far as it is spreading risk, this gradual diversification may work to increase systemic stability at some point in the future but not without increasing problems of international coordination and crisis management now.

Therefore, managing this delicate transition making sure that diversification strengthens resilience without compromising cohesion is the challenge for policymakers. The reserve system's "changing contours" show that order is rebalancing, moving away from dollar-centric hegemony and toward a pragmatic equilibrium shaped by several anchors, rather than

declining. Global financial governance will have to change as a result of this evolution, striking a balance between national interests and the stability of the global monetary order as well as between innovation and trust.