“Lumpy , unpredictable, potentially large”: that was how Tim Geithner, then head of the New York Federal Reserve, described the need for dollars in emerging economies in the dark days of October 2008, according to transcripts of a Fed meeting released last month. To help smooth out those lumps, the Fed offered to “swap” currencies with four favoured central banks, as far off as South Korea and Singapore. They could exchange their own money for dollars at the prevailing exchange rate (on condition that they later swap them back again at the same rate). Why did the Fed decide to reach so far beyond its shores? It worried that stress in a financially connected emerging economy could eventually hurt America. But Mr Geithner also hinted at another motive. “The privilege of being the reserve currency of the world comes with some burdens,” he said.

That privilege is the subject of a new book, “The Dollar Trap”, by Eswar Prasad of Cornell University, who shares the world’s ambivalence towards the currency. The 2008 financial crisis might have been expected to erode the dollar’s global prominence. Instead, he argues, it cemented it. America’s fragility was, paradoxically, a source of strength for its currency.

In the last four months of 2008 America attracted net capital inflows of half a trillion dollars. The dollar was a haven in tumultuous times, even when the tumult originated in America itself. The crisis also “shattered conventional views” about the adequate level of foreign-exchange reserves, prompting emerging economies with large dollar hoards to hoard even more. Finally, America’s slump forced the Fed to ease monetary policy dramatically. In response, central banks in emerging economies bought dollars to stop their own currencies rising too fast.

Could Fed swap lines serve as a less costly alternative to rampant reserve accumulation? If central banks could obtain dollars from the Fed whenever the need arose, they would not need to husband their own supplies. The demand is there: India, Indonesia, the Dominican Republic and Peru have all made inquiries. The swap lines are good business: the Fed keeps the

interest from the foreign central bank's loans to banks, even though the other central bank bears the credit risk. The Fed earned 6.84% from South Korea's first swap, for example. But it is not a business the Fed wants to be in. As one official said, "We're not advertising."

Swap lines would help emerging economies endure the dollar's reign. But will that reign endure? Mr Prasad thinks so. The dollar's position is "suboptimal but stable and self-reinforcing," he writes. Much as Mr Prasad finds America's privileges distasteful, his book points to the country's qualifications for the job.

America is not only the world's biggest economy, but also among the most sophisticated. Size and sophistication do not always go together. In the 1900s the pound was the global reserve currency and Britain's financial system had the widest reach. But America was the bigger economy. In the 2020s China will probably be the world's biggest economy, but not the most advanced.

America's sophistication is reflected in the depth of its financial markets. It is unusually good at creating tradeable claims on the profits and revenues that its economy generates. In a more primitive system, these spoils would mostly accrue to the state or tycoons; in America, they back a vast range of financial assets.

Mr Prasad draws the obvious contrast with China and its currency, the yuan, a "widely hyped" alternative to the dollar. China's GDP is now over half the size of America's. But its debt markets are one-eighth as big, and foreigners are permitted to own only a tiny fraction of them. China's low central-government debt should be a source of strength for its currency. But it also limits the volume of financial instruments on offer.

America has a big external balance-sheet, if not an obviously strong one. Its foreign liabilities exceed its overseas assets. But this worrying fact conceals a saving grace: its foreign assets are unusually adventurous and lucrative. Its liabilities, on the other

hand, are largely liquid, safe and low-yielding. America therefore earns more on its foreign assets than it pays on its foreign liabilities.

Alongside its economic maturity, America also has a greying population. This ageing is a source of economic weakness. But, Mr Prasad argues, it may be another reason for the dollar's global appeal. America's pensioners hold a big chunk of the government debt that is not held by foreigners. A formidable political constituency, they will not allow the government to inflate away the value of these claims. Thus America's powerful pensioners serve to protect the interests of its generous foreign creditors.

America's sophistication has one final implication: the dollar has no long-term tendency to strengthen. That again contrasts with its principal long-run rival. China is still a catch-up economy. As it narrows the productivity gap with America, its exchange rate, adjusted for inflation, will tend to rise. The yuan has appreciated by about 35% against the dollar since mid-2005.

A self-deprecating currency

The dollar's depreciation over that period is, of course, bad for anyone holding American assets. But the dollar is not merely a store of value. It has also become a popular "funding" currency. Banks and multinational firms borrow in dollars, even as they accumulate assets in other denominations. Since no one wants to borrow in a currency that only goes up, this is not a role that China's currency could easily play. Moreover, because of its role as a funding currency, the dollar tends to strengthen in times of crisis. That explains why emerging economies feel a "lumpy", "unpredictable" need for dollars. America's currency may not hold its value against others. But in times of stress, the appeal of a dollar asset is that it always holds its value against a dollar debt. The dollar is a global hegemon partly because it is also a global hedge.