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Reverse Kindleberger Trap

Reasons to worry about next financial crisis

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OPINION

A worrying feature of the next big financial crisis is that we may lack a dominant power able and willing to stabilise the international economic order.

That would certainly have been the view of the late economic historian Charles Kindleberger, who argued that the length and depth of the 1930s Depression was due to the failure of either Great Britain or the US to act as a responsible hegemon in the global economy.

Kindleberger's view was that an impoverished Great Britain, the declining hegemon, was unable to provide leadership; and that an isolationist US, the rising hegemon, was unwilling. Hence, the eponymous trap.

And so, the world lacked an open trading system, any credible coordination of economic policies, or a reliable international lender of last resort.

"When every country turned to protect its national private interest, the world public interest went down the drain, and with it, the private interests of all."

These days, though, the new Kindleberger Trap is a bit different to the original.

Now, risk stems not so much from the unwillingness of the rising hegemon in Beijing to help stabilise the system; but rather from the unwillingness of the incumbent hegemon in Washington. A "reverse Kindleberger Trap," if you like.

The 2008 crisis

That will be new since unwillingness certainly didn't feature in the way the US managed the fallout of the Lehman crisis in 2008.

Back then, huge amounts of dollar liquidity were provided through a network of collateralised lending facilities to global banks, especially in Europe, which had built up very large reliance on dollar funding.

In addition, the Fed's QE programme itself provided huge direct support to the international financial system: more than half the Fed's purchases of mortgage-backed securities were sold to it by foreign firms.

And 14 central banks had access to substantial amounts of dollar liquidity from the Fed's currency swap lines. By the summer of 2010, the Fed had supplied $10 trillion at various maturities.

Of course, the US acted in its own self-interest. If the Fed hadn't provided this liquidity, European banks and global asset managers would have been forced to sell off their dollar portfolios at fire-sale prices. But the effectiveness of US crisis management was firmly on display.

And US credibility was rewarded by a substantial inflow into the US bond market as a "safe haven": foreigners bought nearly a trillion dollars of US Treasury securities in the 12 months after the Lehman crisis.

A Trump-era crisis

A Trump-era financial crisis, should it happen, will take place under very different circumstances. Three problems stand out.

The first is that a Trump administration noted for its transactional behaviour could end up being highly selective about who it offers liquidity to.

We've already seen this selectivity in action. In October last year, the US administration supplied a $20 billion swap facility to the Argentine central bank, in an effort to stabilise the peso in the run up to midterm elections that might have posed a risk to President Milei's authority.

Earlier this year there was discussion about a proposed swap line for the central bank of the United Arab Emirates, a bizarre possibility, less for the fact that the UAE is a key US ally, but more for the fact that it is a country rather flush with dollar liquidity, notwithstanding the war with Iran.

The second is the market's growing ability to question the safe-haven status of US treasury bonds.

In the past few weeks, Scott Bessent, the US treasury secretary, has twice revealed his unwillingness to let the market decide what the price of US debt should be.

The first was his effort to support the Japanese yen in a way that was clearly aimed at discouraging Japan from selling any of the $1 trillion of US Treasury bonds that it owns, in effect directing Japan instead to use its bonds as collateral to borrow the money it needed to fund its intervention in the foreign exchange market.

And Bessent's more recent announcement to increase Treasury buybacks of its own debt were also motivated by fear that, left to its own devices, the market might charge Washington rates of interest on US public debt that could embarrass the administration. Interventions like these are not at all consistent with the full price discovery that should be the hallmark of a credible US Treasury market.

Elevated dollar

A third, related, problem has to do with the elevated level of the dollar.

The last 15 years have seen huge capital inflows into the US, for reasons both good (global technology leadership) and bad (absurdly high-budget deficits).

During that period, the stock of foreign-owned US securities has risen from around $12 trillion to over $37 trillion.

As a result of all these capital inflows, the dollar is, in inflation-adjusted, trade-weighted terms, nearly as

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Argentina's President Javier Milei (L) reaches to shake hands with US Treasury Secretary Scott Bessent at a press conference in Buenos Aires, Argentina, in April 2025.

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