

Credit and Power

The Decoupling of Dollar and Treasury Specialness

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ABSTRACT

The premium the world pays for U.S. Treasuries has decoupled from the premium it pays for the dollar. Measured against foreign sovereigns on a covered-interest-parity basis, the Treasury premium has been negative since 2021; the dollar premium has not. The funding instruments of American power are therefore under measurable pressure, and the mechanism is fiscal quantity rather than fiscal credibility: the stock of Treasuries has grown faster than the intermediation capacity and the relative supply of alternatives that once absorbed it at a premium. A companion paper argued that China's decline is largely endogenous and that the United States can accelerate or retard it only at the margin, so that American success depends less on what Washington does to Beijing than on whether it preserves its own structural advantages. This paper tests that claim in the domain where it is cleanest. Fiscal deterioration is the purest case of strategic self-harm: it depletes the advantages on which American statecraft depends, with no foreign cause. The paper's contribution is a strategic-solvency threshold — defined by the joint behavior of five observable series, with stated trigger values, rather than by any debt-to-GDP level — together with the specification of the object that threshold prices, which has split in two. The April 2025 episode, in which Treasuries and the dollar sold off together, is examined as the one observation that bears directly on whether the split will hold. The threshold is approached on the Treasury side and not crossed on the dollar side. The deciding constraint on American power has become internal, and the fiscal path is where that is most visible, because the remedy is known, has been executed before, and was abandoned.

KEYWORDS

fiscal credibility; economic statecraft; reserve currency; convenience yield; term premium; deterrence; grand strategy; peak China.

JEL CLASSIFICATION

E62, E43, F31, F33, F51, H63, G15.

METHOD AND DISCLOSURE

This is a structured qualitative assessment, not a formal model or an original estimation. It advances no new data and no identification strategy; its contribution is a framework, a specification of the object that framework prices, and an assembly of measured magnitudes from primary and peer-reviewed sources. Generative AI was used in drafting, editing, and source verification. All analytical claims, judgments, and errors are the author's.

GOVERNING JUDGMENT

The Treasury premium and the dollar premium have decoupled. The funding instruments of American power are under measured pressure through a fiscal-quantity channel; the sanctions instrument is not, and its exposure is a lagged risk conditional on a migration that is not yet in the data. The threshold is approached on the Treasury side and not crossed on the dollar side.

FALSIFICATION

Five conditions are specified in Section 7 — three that would disconfirm the diagnosis, two that would defeat the strategy-level claims independently. The single sharpest reading is the dollar convenience premium turning down toward the Treasury premium across four or more consecutive quarters.

IF YOU READ NOTHING ELSE

The split

Two premiums that used to move together have come apart. Treasury specialness has been negative since 2021, at about –26 basis points against G10 sovereigns; dollar specialness has held at roughly +20. Reading them as one object produces either a false alarm or a missed one.

The mechanism

Quantity, not credibility. The market charges for absorbing supply on a constrained balance sheet; the measured association survives controls for sovereign credit risk. Nothing here says the market is pricing U.S. default.

Why it is strategic

Net interest has exceeded national defense in the actuals since fiscal 2024 and is projected to roughly double against it by 2036. The remedy is known, was executed in 1990–93, worked, and was abandoned when the enforcement mechanisms lapsed.

1 Introduction and Claim

A companion paper in this series argued that China's economic decline is chronic, self-inflicted, and largely beyond the reach of external inducement — that it can be neither caused nor prevented from Washington, only accelerated or retarded at the margin, and that American success therefore turns less on what the United States does to China than on whether it preserves the structural advantages that make its own statecraft work.¹ That paper named four such advantages — reserve-currency depth, demographic optionality, alliances, and the capacity for institutional self-correction — and treated them as boundary conditions rather than analyzing any of them. This paper analyzes the first, because it is the one where the argument that American decline is a choice rather than a fate can be tested against measured series rather than asserted.

The claim is that fiscal deterioration is the clearest instance of strategic self-harm available: it depletes the capacity on which deterrence affordability, crisis-response borrowing, and industrial-policy room depend, and it exposes sanctions reach to a lagged risk, and it does so with no foreign cause. China need not win the fiscal contest; the United States can forfeit it unassisted. This is the companion paper's asymmetry — decline as a choice, not a fate — carried into the one domain where every term is domestic.

The fiscal question is usually misclassified. Treated as macroeconomics, it is one debate among many, adjudicated on growth and distribution. Treated as national security, it is the master constraint on the other instruments. The contribution here is not the observation that the debt is large, which is common ground, nor the observation that interest now exceeds defense, which is widely made and, as Section 5.1 notes, already true in the actuals. It is a device for locating when the debt begins to cost strategic

1. “Insulate, Then Press: A Sequencing Framework for U.S. Policy Toward a Structurally Declining China,” WP-2026 working paper series, Sanctir LLC. Several claims in Sections 5.3 and 5.4 below are defined there rather than here; the companion paper should be consulted alongside this one. Its concluding claim — that China's decline is close to automatic while American success is not — is the premise this paper takes up.

capability — a strategic-solvency threshold defined by the joint reading of observable series rather than by a level — and a specification of the object that threshold prices, which recent measurement has shown to be not one thing but two that have come apart.

Two corrections to an earlier draft govern the argument and are stated at the outset. First, the negative Treasury premium is a supply-and-intermediation phenomenon, not a default-risk phenomenon: the study that measures it finds the debt-to-GDP association survives controls for sovereign credit risk, and attributes the level shift to swap-spread compression and relative issuance. This paper therefore does not claim that the market is pricing U.S. default or that the marginal buyer doubts repayment. It claims something narrower and better supported: that the volume of Treasuries has outrun the capacity to hold them at a premium, and that volume is a fiscal choice. Second, the link between dollar convenience and sanctions reach is this paper's hypothesis, grounded in the weaponized-interdependence literature, and is not a finding of the convenience-yield study it cites. Section 5.4 states the hypothesis as one.

The method is structured qualitative assessment: a decision framework specified in advance and applied to cases, not a formal model. Empirical magnitudes are drawn from primary and institutional sources — the Congressional Budget Office, the Treasury, the Federal Reserve, the IMF, and the peer-reviewed literature — with contemporaneous reporting used only to characterize events. Section 2 establishes fiscal credibility as a strategic asset. Section 3 concedes the reserve-currency privilege at full strength and extracts the one thing that survives the concession. Section 4 builds the threshold, separates the two premiums, and reads the April 2025 episode against the distinction. Section 5 traces the transmission channels, funding first because that is where the measured damage lies and sanctions last because that is where it does not. Sections 6 through 8 address the availability objection, state what would falsify the assessment, and draw the parallel to China that closes the pair. Section 9 concludes.

2 Fiscal Credibility as a Strategic Asset

Fiscal credibility is ordinarily valued as a domestic good: low and stable borrowing costs, room to respond to recessions, intergenerational fairness. Those are real, and they are not the subject here. The claim of this section is that fiscal position is, before it is any of those things, the enabling condition for four instruments of statecraft, and that its value is therefore strategic first and economic second. If the section is granted, the rest of the paper follows; if it is not, nothing does.

The four capabilities, in the order the evidence supports them:

- **Deterrence affordability.** A force posture is funded out of discretionary space, and discretionary space is what a rising mandatory-interest claim compresses. The capacity to sustain deterrence without a funding crisis is a fiscal capacity before it is a military one.
- **Crisis-response borrowing.** The ability to borrow massively and cheaply in a genuine emergency — war, pandemic, systemic financial crisis — without triggering a funding crisis is fiscal space held as a strategic reserve. It is invisible until the emergency arrives, which is what makes its depletion the most dangerous.

- **Industrial-policy room.** The fiscal room to fund the instruments the companion paper prescribes — Defense Production Act appropriations, defense stockpiles, guaranteed offtake for critical-minerals refining — is a precondition for that entire strategy. The sequencing framework is fiscally conditional, a point Section 5.3 makes concrete.
- **Sanctions reach.** Financial sanctions bite because exclusion from dollar clearing is costly. That cost is set primarily by the topology of the correspondent-banking network and the jurisdictional reach of U.S. law over it, and only secondarily by the premium the world pays to hold dollar assets. The fiscal position bears on the second term, not the first, which is why this capability is listed last and treated in Section 5.4 as a lagged and conditional exposure rather than a present loss.

The move is definitional and it is the paper's foundation: an economic variable is reframed as a strategic one. Each of the four is a way of spending capacity that the fiscal position accumulates or depletes. The sections that follow measure the depletion — but only after Section 3 concedes, at full strength, the objection that the depletion may not matter.

3 The Strongest Objection: The Privilege Is Durable

3.1 The privilege is intact

Before any claim that fiscal position constrains statecraft can stand, it must survive the objection that the reserve-currency privilege has absorbed decades of deficits without penalty and has no ready substitute. The objection is strong, the current data supports it more than it supports the alarmists, and the paper concedes it at close to full strength.

The dollar is 57.1 percent of official foreign-exchange reserves in the first quarter of 2026 — up from 56.4 percent the prior quarter, with about half the increase attributable to exchange-rate valuation — and down from above 70 percent in 2000, with most of the long decline attributable to valuation and to diversification into currencies of smaller economies rather than to any rival.² The transactional shares are higher and have barely moved: the dollar is roughly half of cross-border payment value on the SWIFT network and about three-quarters once intra-eurozone flows are excluded, about 80 percent of trade-finance value, and on one side of 89 percent of global foreign-exchange turnover.³ No alternative reserve asset exists at the scale a meaningful reallocation would require: the euro sits atop an incomplete fiscal union, the renminbi is capital-controlled, and gold and digital assets are not reserve substitutes at reserve

2. International Monetary Fund, Currency Composition of Official Foreign Exchange Reserves (COFER), 2026Q1 (IMF Data Brief, July 1, 2026): the dollar's share rose to 57.13 percent from 56.42 percent in 2025Q4, with exchange-rate valuation accounting for roughly half of the increase. The 2025Q4 figure is restated from the 56.77 percent in the March 27, 2026 release, following a correction of reporting errors involving the Swiss franc. Since the 2025Q3 release the IMF reports currency shares of total reserves with an imputed component, revised back to 2000Q1, and no longer publishes an “allocated/unallocated” split (IMF, “Improving the Analytical Usefulness of the IMF's COFER Data,” November 2025). The share was above 70 percent in 2000. The 2026Q2 release is expected around October 1, 2026; 2026Q1 is the latest observation as of writing.

3. SWIFT Global Currency Tracker, June and July 2026: dollar share of cross-border payment value 50.1 percent (June 2026), roughly 75 percent excluding intra-eurozone flows; trade-finance share 81.2 percent (June) and 79.9 percent (July). Bank for International Settlements, *Triennial Central Bank Survey of Foreign Exchange and OTC Derivatives Markets* (2025): the dollar on one side of 89 percent of turnover, up from 88 percent in 2022. Atlantic Council, Dollar Dominance Monitor, for the roughly 54 percent invoicing share.

scale. The privilege has also already survived the stressors that were supposed to end it — the debt-limit standoffs of 2011, 2023, and 2025; the loss of the top credit rating from all three major agencies, completed by Moody's in May 2025;⁴ and a roughly two-fold rise in the average interest rate on marketable debt since early 2022, which, applied to a larger stock, nearly tripled the annual interest bill between fiscal 2020 and fiscal 2025.⁵ A paper predicting imminent displacement would be wrong, and the reader is right to distrust one.

3.2 What the bid shift is allowed to mean

The one thing that survives the concession is a change in who holds the debt, and it must be stated at exactly its weight. Three facts fix that weight. First, the official sector's share of foreign Treasury holdings has fallen for years, from roughly 59 percent in 2020 to about 42 percent at the end of 2025 on the benchmark-survey basis, with private foreign investors overtaking official holders in 2023.⁶ Second, the foreign total has not shrunk — it sits near \$9.3 trillion — because price-sensitive private demand has absorbed the paper the official sector stopped accumulating.⁷ Third, the official retreat is a retreat from accumulation, tied to slower reserve growth, not a documented rotation out of Treasuries into other U.S. assets; the growth in foreign equity and agency exposure is overwhelmingly private and, for equities, largely valuation. China's multi-year reduction, to its lowest level since 2008, is one instance of the official-sector pattern, not its cause.

The same shift has occurred on the domestic side, and an earlier draft omitted it. The Federal Reserve was the largest single price-insensitive buyer of Treasuries over 2020–2021 and then, through balance-sheet runoff over 2022–2025, a net seller; the stock it shed was absorbed by money-market funds, hedge funds running cash-futures basis trades, and other private holders whose demand is a function of price and of balance-sheet cost. Two smaller developments run the other way and are noted for completeness: the statutory reserve requirements for dollar stablecoins enacted in July 2025 create a structural bid at the bill end of the curve, and the 2025 revision of the enhanced supplementary leverage ratio eased the dealer balance-sheet constraint that Section 4 identifies as the proximate cause of the negative Treasury premium. Neither is of a size to reverse the pattern.⁸

4. Standard & Poor's, August 5, 2011 (AAA to AA+); Fitch Ratings, August 1, 2023 (AAA to AA+); Moody's Investors Service, May 16, 2025 (Aaa to Aa1). The Moody's action completed the loss of the top rating from all three major agencies. Debt-limit standoffs were resolved by the Fiscal Responsibility Act of 2023 and, in July 2025, by a \$5 trillion increase enacted in the reconciliation act.

5. U.S. Treasury, Fiscal Data, Average Interest Rates on U.S. Treasury Securities: the weighted-average rate on total marketable debt rose from 1.42 percent (February 2022) to 3.45 percent (July 2026), a factor of roughly 2.4. Net interest outlays rose from \$345 billion (FY2020) to \$970 billion (FY2025), a factor of 2.8 (Congressional Budget Office, *Monthly Budget Review*, FY2025 summary). The rate roughly doubled; the bill nearly tripled. The two are routinely conflated in commentary and are kept distinct here.

6. U.S. Department of the Treasury, *Foreign Portfolio Holdings of U.S. Securities as of June 30, 2025* (shl2025r, released April 30, 2026); Congressional Research Service, "Foreign Holdings of Federal Debt," RS22331 (updated April 22, 2026), reporting the official share of foreign holdings at 41.9 percent as of December 2025. Two classifications are in use and are not spliced here: the annual benchmark survey, which reattributes custodial holdings to beneficial owners, and the monthly Major Foreign Holders table, which relies on custodial reporting and has shown the official share at roughly 40 to 41 percent in 2026. Both show the same direction; the level differs by several points. Private holders surpassed official holders in 2023 on the survey basis.

7. U.S. Treasury, TIC Major Foreign Holders of Treasury Securities (Table 5), June 2026 (released August 17, 2026): total foreign holdings \$9,299.0 billion; foreign official \$3,778.1 billion, down from \$4,011.0 billion in February 2026. China's holdings at their lowest level since September 2008. Monthly figures are custodial estimates.

The external accounts close the loop, and a paper about the Treasury bid that ignores them is incomplete. The current-account deficit is the mirror of net foreign purchases of U.S. assets: in 2025 it ran \$1.12 trillion, 3.6 percent of GDP, down from 4.0 percent a year earlier, while the goods deficit rose to about \$1.24 trillion and was offset by a larger services surplus. Foreign holdings of Treasuries reached \$9.27 trillion at year-end, but the composition of the financing had shifted — private investors buying equities and corporate bonds, not reserve managers buying notes, supplied most of the inflow.⁹ Two implications follow for the marginal buyer. First, a trade policy that succeeds in narrowing the deficit narrows, by identity, the foreign saving that finances the debt; the tariffs of 2025 were sold as a remedy for the first and were, to the extent they worked, a subtraction from the second. Second, financing that arrives as private demand for risk assets rather than official demand for safe ones is financing that leaves when returns disappoint, which is what the April 2025 episode showed. The reserve-currency privilege is the ability to run the deficit and fund it at a premium; Section 4 measures the premium, and the external accounts show that the counterparty to it is now the one that charges.

The marginal Treasury buyer, foreign and domestic, is more price-sensitive than a decade ago, and demands compensation for absorbing supply where the buyer a decade ago did not.

That is the whole of the claim, and the paper claims no more. It does not claim the dollar is being abandoned, that reserve managers are fleeing dollar assets, or that a substitute is emerging. It claims that the buyer at the margin now charges for quantity — the precondition for the price effects Section 4 measures and Section 5 traces.

8. The Federal Reserve redeemed about \$1.6 trillion of Treasury securities through balance-sheet runoff between June 2022 and December 1, 2025, when runoff ended (FOMC statement, October 29, 2025; Federal Reserve, “Policy Normalization”); it has since conducted reserve-management purchases of Treasury bills (Treasury Borrowing Advisory Committee, Q1 2026). The marginal buyer over the runoff window was therefore private and price-sensitive on the domestic side as well. On stablecoin demand, the GENIUS Act (Pub. L. 119-27, July 18, 2025) requires issuers to hold reserves one-for-one in cash, insured deposits, Treasury bills of 93 days or less, and comparable instruments; TBAC’s April 2025 estimate was that a \$2 trillion stablecoin market by 2028 would require more than \$1 trillion of additional bills. The bid is real, but it is confined to maturities under one year. On dealer capacity, the banking agencies finalized the revision of the enhanced supplementary leverage ratio on November 25, 2025 (effective April 1, 2026), replacing the fixed 2 percent buffer with half of each firm’s Method 1 GSIB surcharge at the holding company, and with half the parent’s surcharge capped at 1 percent at the depository subsidiary; it eased, without removing, the constraint discussed in Section 4.2. On the long end, a 2026 selloff that took the thirty-year yield to its highest level since 2007 prompted Treasury to double the maximum size of its long-dated buyback operations effective September 9, 2026 (Treasury press release sb0607).

9. Bureau of Economic Analysis, “U.S. International Transactions and Investment Position, Fourth Quarter and Year 2025” (BEA 25-17, March 25, 2026): current-account deficit \$1.12 trillion, 3.6 percent of GDP, down from 4.0 percent in 2024. Census Bureau and BEA, “U.S. International Trade in Goods and Services, December and Annual 2025” (February 19, 2026): goods deficit \$1,240.9 billion; services surplus \$339.5 billion. Treasury TIC: net foreign purchases of Treasuries about \$472 billion through September 2025; foreign holdings \$9.27 trillion at December 2025, led by Japan, the United Kingdom, and China. Rebecca Patterson and Ishaan Thakker, “Trade, Tariffs, and Treasuries,” Council on Foreign Relations (December 17, 2025); Brad Setser (CFR) on the shift of external financing toward private equity and corporate-bond inflows. Gourinchas and Rey (2007) for the balance-sheet framing.

4 The Strategic-Solvency Threshold: A Dashboard of One Object

4.1 Two premiums

The organizing device is not a debt-to-GDP number past which alarms sound. It is a threshold defined by a change in kind: the point at which fiscal position stops being a domestic budgeting matter and begins to price into the instruments of statecraft themselves. Below it, deficits are an economic debate; above it, each increment of deterioration subtracts from a specific capability. The threshold cannot be read off any single series, because it is a joint event, and because the object being priced is not one thing but two that have come apart.

That last point is the whole of the device, so it is stated before the dashboard. The world pays two premiums that are easy to conflate. One is *dollar specialness* — the convenience of holding and settling in dollars, measured as the premium on dollar-denominated safe assets over comparable foreign-currency assets after hedging. The other is *Treasury specialness* — the specific premium on U.S. government paper relative to other safe dollar claims and to foreign sovereigns, which underwrites the government's own cost of funding. For most of the postwar period they moved together and treating them as one object was harmless. They have now decoupled, and the decoupling is measured: from 2021 onward the average five-year Treasury premium across G10 currencies ran about negative 26 basis points, against negative 7 basis points over 2012–2020, while the dollar premium held at roughly positive 20 basis points.¹⁰ The funding instrument has lost its premium; the dollar has not. A dashboard that fails to separate them will read a funding problem as a dollar crisis, or dismiss a real funding problem because the dollar looks fine.

4.2 What the negative premium is and is not

The measure requires a precise reading, because the natural one is wrong. The Treasury premium in this literature is a covered-interest-parity object: the yield on a Treasury against the synthetic dollar yield obtained by holding a foreign sovereign and hedging the currency.¹¹ It went negative for two reasons the study identifies and this paper adopts without embellishment. The proximate reason is the collapse of U.S. swap spreads after 2015: post-crisis leverage rules made it costly for dealers to warehouse Treasuries, so Treasury yields rose above the swap curve, and a security that trades cheap to swaps trades cheap to hedged foreign sovereigns too.¹² The structural reason is relative supply: the stock of U.S. government debt has grown faster than the stock of other developed-market sovereign debt, and the premium falls as the relative supply rises. The estimated sensitivity — a decline of 0.37 to 0.86 basis

^{10.} Wenxin Du, Ritt Keerati, and Jesse Schreger, “Decoupling Dollar and Treasury Privilege,” NBER Working Paper 35000 (March 2026); Federal Reserve Board International Finance Discussion Paper 1427 (December 2025); SSRN 5687043 (October 30, 2025). Average five-year Treasury premium across G10 currencies –26 basis points from 2021 onward versus –7 basis points over 2012–2020; dollar convenience roughly +20 basis points over 2021–2025; a one-percentage-point rise in U.S. debt-to-GDP associated with a 0.37 to 0.86 basis-point decline in the Treasury premium (2000–2024), holding after controls for sovereign credit risk and global risk sentiment. The authors attribute the divergence proximately to the collapse of U.S. swap spreads and structurally to the relative supply of U.S. versus other developed-market government debt. They draw no link to sanctions; that link is this paper's hypothesis, and is stated as such in Section 5.4.

^{11.} Wenxin Du, Joanne Im, and Jesse Schreger, “The U.S. Treasury Premium,” *Journal of International Economics* 112 (2018): 167–181, which introduced the CIP-based Treasury-premium measure the later paper extends; Zhengyang Jiang, Arvind Krishnamurthy, and Hanno Lustig, “Foreign Safe Asset Demand and the Dollar Exchange Rate,” *Journal of Finance* 76(3) (2021): 1049–1089.

points per percentage point of U.S. debt-to-GDP, over 2000–2024 — holds after controlling for sovereign credit risk and global risk sentiment.

Three consequences follow, and each narrows a claim an earlier draft made too broadly. The negative premium is not the market pricing U.S. default; the credit-risk control rules that reading out. It is not evidence that the marginal buyer doubts repayment; it is evidence that the marginal buyer charges for absorbing quantity on a constrained balance sheet. And the coefficient is small in level — it is a cross-currency object measured against foreign sovereigns, not comparable to the domestic convenience yield of Krishnamurthy and Vissing-Jorgensen, which is measured against corporate spreads and is an order of magnitude larger; the two agree on sign and on the supply mechanism and disagree only in the benchmark.¹³ What the measure does establish is the thing the paper needs: the premium the government earns on its own paper responds to how much of that paper it issues, and the response has been large enough since 2021 to take the premium below zero. That is a fiscal-quantity channel. It runs on the volume of debt, which is a policy variable, and it is the channel through which the market has begun to charge the United States for its fiscal path even while assigning it no default risk.¹⁴

4.3 The dashboard

The markers below are therefore reported together, with dollar specialness placed deliberately alongside the four series that have moved, as the one that has not. Each row carries a stated trigger — the reading at which this paper would say the threshold has been crossed on that dimension — so that the device is falsifiable on its own terms and not only by the conditions in Section 7. The triggers are a monitoring convention, chosen by the author to be legible and to sit outside the range observed since 2012; they are not derived from a loss function, an optimizing model, or any threshold in the literature, and a reader who prefers different values can substitute them without disturbing the argument. Proximity to the threshold is the joint reading.

Marker	Reads on	Latest (dated)	Trigger	Status
Net interest / revenue	Funding burden	18.6% (FY2026 proj.); ~25.8% by 2036	> 25% sustained	Rising; below trigger
Official share of foreign Treasury bid	Buyer price-sensitivity	~42% (Dec. 2025), from ~59% (2020)	< 35%	Falling; below trigger

^{12.} On the post-2015 collapse of swap spreads and its regulatory origin, see Federal Reserve staff analyses of the supplementary leverage ratio and dealer intermediation capacity, and Du, Keerati, and Schreger (2025), §3. The point is not contested in the literature: negative Treasury–swap spreads reflect the cost of warehousing Treasuries on constrained balance sheets, and that cost rises with the stock to be warehoused.

^{13.} Arvind Krishnamurthy and Annette Vissing-Jorgensen, “The Aggregate Demand for Treasury Debt,” *Journal of Political Economy* 120(2) (2012): 233–267. Their convenience yield is measured against corporate spreads over 1926–2008, averages roughly 73 basis points, and responds to Treasury supply with economically large elasticities. The Du–Keerati–Schreger coefficient is a cross-currency, CIP-relative object measured against foreign sovereigns and is not comparable in level; the two literatures agree on sign and on the supply mechanism.

^{14.} Zhengyang Jiang, Hanno Lustig, Stijn Van Nieuwerburgh, and Mindy Z. Xiaolan, “The U.S. Public Debt Valuation Puzzle,” *Econometrica* 92(4) (2024): 1309–1347; Zhengyang Jiang, Hanno Lustig, Stijn Van Nieuwerburgh, and Mindy Z. Xiaolan, “Manufacturing Risk-Free Government Debt,” NBER Working Paper 27786 (2020).

Marker	Reads on	Latest (dated)	Trigger	Status
10-yr term premium (ACM)	Duration-risk compensation	0.80% (Aug. 13, 2026); positive since Oct. 2024	> 1.5% sustained	Elevated vs. 2010s; below trigger
Treasury premium (5-yr, G10 avg.)	Treasury specialness	~ -26 bp (2021 onward)	< -50 bp sustained	Negative; approaching
Dollar premium (5-yr, G10 avg.)	Dollar specialness	~ +20 bp (2021–2025)	< 0 sustained	Holding; not approached

Every cell above is reproducible from a public series on the cadence given in Appendix A; the interest-to-revenue ratio is CBO's projected net interest divided by its projected revenues for the same year (\$1,039 billion against \$5.6 trillion for FY2026). Dates are given where a series is continuous, so that the table reads as an observation rather than an average.

The first four rows point the same way: the funding privilege is being spent. The fifth points the other way, and it is why Section 3's concession is not decoration. The threshold is approached on the Treasury side and not crossed on the dollar side; nothing here says it has been crossed on either. The trigger values are the paper's own and are stated so that a reader can disagree with them; “sustained” means at least four consecutive quarters, for the reason given in Section 4.5.

One row needs a caveat the others do not. The term premium is compensation for duration risk and reflects Treasury supply, the Federal Reserve's balance-sheet path, the foreign-demand mix, and inflation uncertainty together; no standard model decomposes it by cause, and the level differs across models even where the sign does not.¹⁵ The paper reads the row as consistent with a supply effect, because it turned positive as the Fed's runoff and Treasury's coupon issuance both rose, and does not read it as a fiscal-risk premium in isolation. It is on the dashboard because it moves with the others, not because it identifies why.

Two properties follow from reading the rows together. The threshold is nonlinear in prospect: the same incumbency that lets a reserve issuer absorb deterioration without penalty means the funding side gives few gradual warnings, so an approach can look benign until it is a level shift. And the coefficients establishing the mechanism are small, which the paper states plainly rather than inflates. A market that charges under a basis point per point of debt-to-GDP is a market that notices supply, not one that has begun rationing American power. The claim the dashboard supports is proximity and direction, not arrival; writing it as arrival would be the same error, reversed, as denying the decoupling.

4.4 The April 2025 test

The distinction between the two premiums has been tested once since it was measured, and an earlier draft of this paper omitted the test while citing the study that reports it. In the week following the April 2,

2025 tariff announcement, the dollar and Treasuries sold off together in price terms: ten-year yields posted their largest weekly rise since 2001 while the dollar index fell, and the dollar went on to lose a tenth of its value over the first half of the year, its worst first half since 1973. Read as a price event, this looks like the re-merging that Section 7 lists as disconfirming, and that is why the episode is treated at length rather than filed.¹⁶

It is not that, and the reason matters more than the episode. The price of the dollar and the convenience premium on dollar assets are different objects, and this paper's device depends on not confusing them. A convenience premium is what a holder gives up in yield to hold the asset rather than a hedged substitute; an exchange rate is what the asset costs. They can move in opposite directions, and in April 2025 they did. The Treasury premium fell, as the thesis predicts under a policy shock to the issuer. The dollar premium in the measured sense did not fall with it: it rose at short tenors, by roughly twenty-five basis points at three months, as demand for dollar liquidity firmed even while the currency depreciated.¹⁷ The measured objects moved the way this paper says they move, which is apart. A reader who takes the dollar's depreciation for decayed dollar specialness has made precisely the error Section 4.1 exists to prevent.

Three features fix how much the episode carries. First, the cross-section: the Treasury premium fell most against low-debt sovereigns and least against high-debt ones, the signature of a relative-supply-and-safety repricing among sovereigns rather than a flight from the dollar as a unit. Second, the composition: the dollar's transactional shares were unchanged through the year, so the currency's depreciation was a repricing within the dollar system, not an exit from it. Third, the cause: the shock was a policy announcement that raised the expected volatility of U.S. trade and fiscal policy at once, which is the kind of shock that should move the issuer's paper without moving the world's demand to settle in the issuer's currency — and that is what the measurements show.

The honest reading is that April 2025 confirms the split rather than threatening it, and that the threat it poses is to the reader rather than to the thesis: the episode is a standing invitation to mistake a cheap dollar for an unwanted one. What would genuinely disconfirm this paper is the dollar convenience premium falling with the Treasury premium and staying down. That did not happen here, and it has not happened since. Section 7 keeps the co-movement as the first-listed falsifier, now specified on the measured premium rather than on the exchange rate.

^{15.} Federal Reserve Bank of New York, Adrian–Crump–Moench (ACM) ten-year term premium, daily series: positive since October 2024; 0.667 percent (May 2026), 0.513 percent (June 2026), and 0.80 percent on August 13, 2026. Term-premium estimates are model-dependent; the Kim–Wright series shows the same sign change with different levels. Neither model decomposes the premium by cause.

^{16.} Du, Keerati, and Schreger (2025), §5, document a marked decline in the Treasury premium following the April 2, 2025 tariff announcement, largest against low-debt issuers (Australia, Germany, Sweden) and smallest against high-debt issuers (United Kingdom, Japan). On the exchange-rate side, the dollar index fell 10.8 percent over the first half of 2025, its worst first half since 1973, while the ten-year yield posted its largest weekly rise since 2001, roughly 50 basis points, in the week of April 7–11 (Reuters, April 11, 2025; Bloomberg, June 30, 2025) — the co-movement that distinguishes the episode from 2008 and 2020. The tariffs themselves were held unauthorized by the Supreme Court in February 2026; the market response they provoked is the datum, not their legal durability.

^{17.} Du, Keerati, and Schreger (2025), §5, on the April 2025 window: the ten-year Treasury premium fell about 20 basis points against low-debt sovereigns (Australia, Germany, Sweden) and was little changed against high-debt ones (United Kingdom, Japan), while the short-tenor dollar convenience premium rose, by roughly 25 basis points at three months. The exchange-rate move and the convenience-premium move are separate measurements and are kept separate here.

4.5 Two speeds

One further distinction governs how the dashboard is read, because the two premiums decay at different speeds and through different mechanisms. The migration of the funding problem into the sanctions problem — Treasury specialness eventually dragging dollar specialness down after it — would be slow and structural, working through reserve managers and long-horizon allocation over years, if it happened at all. The plumbing of a crisis is fast, and can move the two in opposite directions on the same day. In March 2020 global demand for dollar funding spiked while the Treasury market's own functioning briefly seized: dollar specialness rose at the very moment Treasury specialness did not, and it took Federal Reserve purchases and a temporary leverage-ratio exemption to restore intermediation.¹⁸ The lesson for the dashboard is that a single stressed reading of any row is not a threshold crossing. A regime change would show as the slow migration, sustained across quarters; the fast plumbing of any one episode is noise against it. This is also why the crisis-response channel below is where the two speeds collide, and where the paper is most careful to state a conditional rather than a forecast.

5 The Transmission Channels

Fiscal deterioration becomes strategic loss through traceable channels, each drawing on one of the two premiums the dashboard separates. The order is deliberate: the funding channels first, because that is where the damage is measured, and the sanctions channel last, because that is where it is not yet.

5.1 The deterrence-affordability channel

This channel runs on Treasury specialness, the row that has moved. The mechanism is a relative price, not a physical queue. Interest and defense do not draw on one literal pool of dollars; interest is mandatory and defense discretionary, and defense as a share of output has declined for three decades for reasons unrelated to debt service. The mechanism is that a larger interest bill raises the political cost of the next defense dollar: when debt service and the deficit are already large and growing, every discretionary appropriation is contested against a mandatory claim visibly crowding the budget.

The fact that gives the mechanism force needs no theory of crowding to be alarming, and it is not a projection. Net interest exceeded national-defense outlays in fiscal 2024 and again in fiscal 2025, in the actuals; CBO's February 2026 baseline then shows the gap widening in every year of the 2026–2036 window.¹⁹

Fiscal year	Net interest	National defense (function 050)
2024 (actual)	~\$882 billion	~\$874 billion

^{18.} On the March 2020 “dash for cash,” see the Bank for International Settlements and Federal Reserve post-mortems (2020–2021) and the Group of Thirty report on Treasury market structure (2021). Treasury market functioning deteriorated even as demand for dollar liquidity surged; the Federal Reserve's March 2020 purchases and the temporary exclusion of Treasuries from the supplementary leverage ratio (April 2020–March 2021) restored intermediation. The episode is cited to distinguish fast crisis plumbing from the slow structural migration the dashboard is built to detect.

Fiscal year	Net interest	National defense (function 050)
2025 (actual)	\$970 billion	\$917 billion
2026 (proj.)	\$1,039 billion	\$885 billion
2036 (proj.)	\$2,144 billion	~\$1,100 billion

The comparison is between two lines of the same budget, not between two claims on one pool of money: net interest is mandatory and defense discretionary, and no interest dollar is taken from a defense account. What the ordering measures is the political cost of the marginal defense dollar, for the reason given below.

The rows are the claim: interest overtook defense in the year the earlier draft treated as the start of a projection, and grows faster across the window, roughly doubling by 2036 while defense rises far less. No intermediate projection year is interpolated; the endpoints carry the point. The comparison is nominal and is offered as an ordering, not as an analysis of sustainability; the analysis belongs to the relation between the interest rate and the growth rate, which is taken up in Section 5.2. The baseline also carries two recent changes that partly offset — the 2025 reconciliation act, which adds to deficits, and tariff collections, which subtract — and the second has since been largely removed by the Supreme Court's February 2026 ruling that the emergency-powers statute does not authorize tariffs, a reversal CBO scores at about \$2.0 trillion over the window, which moves the projection further in the direction the table shows. The paper relies on neither.²⁰ This is the resolution the companion paper deferred — its Phase 3 assumed a sustained deterrence build-out while treating fiscal credibility as a boundary condition, and flagged the competition without resolving it.²¹

19. Congressional Budget Office, *The Budget and Economic Outlook: 2026 to 2036* (February 11, 2026), publication 61882, Table 1-1 for net interest and revenues (FY2026: net interest \$1,039 billion against revenues of \$5.6 trillion, or 18.6 percent; deficit \$1.9 trillion, 5.8 percent of GDP, on the February baseline); supplemental tables for national defense (budget function 050). Figures are projections; FY2026 actuals close after September 30, 2026. Defense is the function-050 line; a broader basis including mandatory defense runs higher without changing the ordering. Actuals for the crossover: net interest exceeded national defense in FY2024 (approximately \$882 billion versus \$874 billion) and FY2025 (\$970 billion versus \$917 billion), so the ordering the projection shows is already history, not forecast.

20. The February 2026 baseline incorporates two offsetting changes since the prior outlook: the 2025 reconciliation act (Pub. L. 119-21), which CBO estimates adds roughly \$4.7 trillion to deficits over 2026–2036, and tariff collections under the 2025 trade actions, estimated to reduce deficits by roughly \$3.0 trillion, both figures inclusive of economic and net-interest effects (CBO, publication 61882, Box 5-1). The tariff component has since been largely undone. On February 20, 2026 the Supreme Court held in *Learning Resources, Inc. v. Trump*, No. 24-1287, that the International Emergency Economic Powers Act does not authorize the President to impose tariffs, and the IEEPA tariffs terminated February 24, 2026. CBO estimates the ruling widens deficits by about \$2.0 trillion over 2026–2036, roughly \$1.6 trillion primary and \$0.4 trillion in additional debt service (CBO, publication 62210, March 2026). CBO's *Monthly Budget Review* of August 10, 2026 (publication 61983) now projects a FY2026 deficit of about \$2.1 trillion against the \$1.9 trillion February figure, with customs collections roughly \$250 billion below the February baseline and about \$100 billion of IEEPA duties already refunded by July 31. The paper relies on neither component.

21. “Insulate, Then Press” (WP-2026), §7, naming the tension between the Phase 3 deterrence build-out and the fiscal-credibility boundary condition. The resolution: the mandatory claim that raises the political cost of the deterrence dollar is already larger than the defense budget, has been since FY2024, and is projected to grow faster for the length of the window.

5.2 The crisis-response channel

Fiscal space is the capacity to borrow massively in an emergency without a funding crisis, and its depletion is the least observable of the four because it shows only when the emergency comes. The historical record is the argument. In both the 2008 financial crisis and the 2020 pandemic the United States borrowed enormously and cheaply, because safe-haven demand drove yields down as issuance surged. In fiscal 2020 the deficit reached 14.9 percent of GDP and debt held by the public rose about 25 percent — yet net interest that year fell, from \$375 billion to \$345 billion, because the ten-year yield collapsed toward one percent and the term premium ran deeply negative.²² The safe-haven bid absorbed the impulse at falling cost; the borrowing was, in real terms, nearly free.

The standard framework for whether that capacity persists is the gap between the interest rate on the debt and the growth rate of the economy. When the rate is below the growth rate, debt can be rolled over and its ratio to output stabilized without a primary surplus; when the rate is above it, stabilization requires one, and the size of the required surplus rises with the stock. The gap was favorable through the 2010s and through 2020, which is why the borrowing of that year was nearly free. It has since narrowed as the average rate on the stock catches up with market rates; on one reading of CBO's February 2026 baseline the two cross around 2031, though CBO itself states no crossover year.²³ The crisis-response capacity is a function of that gap held in reserve; a country that enters an emergency with the gap already near zero does not have the room it had when the gap was two points.

That is the capacity being depleted. The counterfactual is not a forecast but a conditional, and it is stated as one: the same borrowing impulse against a 2026 backdrop — a positive and elevated term premium, a negative Treasury premium, an interest–growth gap near zero, and a marginal buyer shifted from price-insensitive official and central-bank holders to price-sensitive private ones — would plausibly raise yields rather than be absorbed at falling ones, reversing the sign of the crisis-borrowing cost. The 2020 episode worked because Treasury specialness was intact and the safe-haven reflex was reliable. Section 4 shows the first of those conditions already eroded, and April 2025 shows that under a self-inflicted shock the reflex can fail on both premiums at once. Whether it would hold under an external shock is untested precisely because no such crisis has arrived since the decoupling — which is the section's limit, stated rather than filled: the depletion is real, its magnitude is unobservable until the emergency that reveals it, and that unobservability is the danger, not a gap in the argument.

22. Congressional Budget Office, *Monthly Budget Review: Summary for Fiscal Year 2020* (deficit 14.9 percent of GDP, the largest as a share of GDP since 1945), and “Federal Net Interest Costs: A Primer” (publication 56780), reporting net interest of \$375 billion (FY2019) and \$345 billion (FY2020). Government Accountability Office, GAO-21-124: debt held by the public rose approximately \$4.2 trillion (about 25 percent) to \$21.0 trillion. The ten-year yield reached an intraday low near 0.32 percent on March 9, 2020. FY2009 comparison: deficit 9.9 percent of GDP, the prior postwar record.

23. Olivier Blanchard, “Public Debt and Low Interest Rates,” *American Economic Review* 109(4) (2019): 1197–1229; Jason Furman and Lawrence H. Summers, “Eight Questions — and Some Answers — on the U.S. Fiscal Situation,” Harvard Kennedy School, Mossavar-Rahmani Center for Business and Government (December 2024). In CBO's February 2026 projection the ten-year yield averages 4.1 percent in 2026 and 4.4 percent over 2031–2036, real growth averages 1.8 percent over 2027–2036 with inflation near 2 percent (nominal growth of roughly 3.8 to 3.9 percent), and net interest rises from 3.3 percent of GDP in 2026 to 4.6 percent in 2036, or \$1.0 trillion to \$2.1 trillion. CBO, publication 61882, Chapters 2 and 3. CBO does not state a crossover year for the average interest rate against nominal growth; the estimate that the two cross in 2031 is Brookings' reading of the same baseline (Brookings, “An Update on the Federal Budget Outlook,” 2026) and is cited as such.

5.3 The crowding channel and the companion strategy

The interest bill displaces discretionary capacity in general, and in particular it displaces the industrial-policy spending the companion paper's strategy requires. That paper prescribed funding allied critical-minerals refining through Defense Production Act Title III support, defense stockpiles, and guaranteed offtake — and treated the fiscal room for all of it as given. The room is not given; it is the residual that debt service is compressing.

The scale of the prescribed programs is modest against the budget, which is the point: even modest strategic commitments now compete against a mandatory-interest claim that dwarfs them. Defense Production Act Title III appropriations ran at least \$4.4 billion across fiscal 2020–2025; the NdPr price floor at the center of the July 2025 Department of Defense–MP Materials partnership costs on the order of \$300 million a year at the market price prevailing when it was signed.²⁴ These are small numbers. Net interest is a \$1,039 billion number growing to \$2,144 billion. The strategy the companion paper calls essential is affordable many times over on its own terms — and is nonetheless argued for against a residual that the funding channel is narrowing every year. The crowding channel does not say the minerals build-out is unaffordable; it says the fiscal position is turning even plainly affordable strategic commitments into contested ones, which is the mechanism by which a funding problem becomes a strategy problem.

5.4 The sanctions-reach channel — a lagged risk, stated as a hypothesis

This channel runs on the row that has not moved, and its weight is bounded accordingly. The paper's claim here is a hypothesis, and the source of the measurement does not make it. Financial sanctions bite because exclusion from dollar clearing is costly. The primary determinant of that cost is structural: the correspondent-banking network is centralized through a small number of U.S.-jurisdiction nodes, and the reach of secondary sanctions is the reach of U.S. law over those nodes.²⁵ That structure is not a convenience yield and does not move with one. The dollar premium enters as the second-order term — the reason the network is dollar-centered in the first place is that holding and settling in dollars is cheaper than the alternatives — and it is the term the fiscal position can touch.

The hypothesis, then, is this: sanctions leverage is a function of network centrality, which is slow-moving and fiscally insensitive, and of the dollar premium, which is fast-moving and has not yet responded to

²⁴. Congressional Research Service and Taxpayers for Common Sense on Defense Production Act Title III appropriations (at least \$4.4 billion, FY2020–FY2025). On the price floor: the July 10, 2025 Department of Defense–MP Materials agreement set a ten-year floor of \$110 per kilogram for NdPr under a contract-for-difference structure. The Federation of American Scientists estimated the subsidy at roughly \$304 million per year at a \$60 per kilogram market price and about 6,075 tonnes of annual output; the Payne Institute (Colorado School of Mines) reached a similar figure. DoD also purchased \$400 million of Series A convertible preferred (conversion price \$30.03) with a warrant for 11.2 million additional shares, together about 15 percent of shares outstanding as of July 9, 2025, and extended a \$150 million loan; the agreement guarantees the new magnet facility a minimum of \$140 million of annual EBITDA, escalating 2 percent a year, once at full capacity (MP Materials Form 10-Q for the quarter ended June 30, 2025; press release of July 10, 2025). The floor took effect October 1, 2025. Ex-China NdPr prices rose sharply after China's 2025 export controls; the subsidy at current prices is not estimated here.

fiscal position; and a sustained loss of the dollar premium would, over years, erode the incentive that keeps the network dollar-centered. Dollar specialness held at roughly positive 20 basis points over 2021–2025 while Treasury specialness fell to about negative 26.²⁶ Sanctions draw on the first; funding draws on the second. The strategic consequence is therefore not that sanctions reach is eroding now. It is that the sanctions instrument carries a lagged risk, realized only if the decay migrates from Treasury specialness to dollar specialness — which happens if holders eventually treat a chronically cheap Treasury as a reason to hold fewer dollar assets altogether, or if repeated self-inflicted shocks of the April 2025 kind teach them to. That migration is not in the data as a trend; it appeared for one quarter as an event.

The objection to this is that avoidance infrastructure already exists, and it deserves an answer with figures rather than a dismissal. It exists and it works. China's Cross-Border Interbank Payment System settled RMB 180.2 trillion in 2025, on the order of \$26 trillion, and reaches 124 countries through 193 direct and 1,573 indirect participants as of December 31, 2025. Russia and China settle 99.1 percent of their bilateral trade in rubles and yuan, on the Russian finance ministry's own account. Project mBridge survived the Bank for International Settlements' withdrawal in October 2024 and operates as a renminbi-denominated wholesale rail among China, Hong Kong, Thailand, the United Arab Emirates, and Saudi Arabia, outside correspondent banking entirely, though it remains at minimum-viable-product stage. For the specific parties under the heaviest sanctions, dollar clearing has been substantially escaped.²⁷ The bound is the scale. CHIPS settled an average of \$2.014 trillion a day in 2025; CIPS's entire year is about thirteen days of it, and mBridge's cumulative throughput since 2022, put at about \$55.5 billion on the Atlantic Council's unofficial estimate and never published by any participating central bank, is under an hour. The renminbi's share of payment value on the SWIFT network was 3.10 percent in June 2026, below its November 2023 peak of 4.61 percent, having dropped out of the top five payment currencies in

25. Henry Farrell and Abraham L. Newman, "Weaponized Interdependence: How Global Economic Networks Shape State Coercion," *International Security* 44(1) (2019): 42–79; Christopher Clayton, Matteo Maggiori, and Jesse Schreger, "A Framework for Geoeconomics," *Econometrica* 94(1) (2026): 105–136; Cathrin Mohr and Christoph Trebesch, "Geoeconomics," *Annual Review of Economics* 17 (2025): 563–587; Jason Choi, Rishabh Kirpalani, and Diego J. Perez, "The Macroeconomic Implications of U.S. Market Power in Safe Assets," NBER Working Paper 30720 (2022).

26. Wenxin Du, Ritt Keerati, and Jesse Schreger, "Decoupling Dollar and Treasury Privilege," NBER Working Paper 35000 (March 2026); Federal Reserve Board International Finance Discussion Paper 1427 (December 2025); SSRN 5687043 (October 30, 2025). The authors draw no link to sanctions; that link is this paper's hypothesis, and is stated as such here.

27. Cross-Border Interbank Payment System: RMB 180.2 trillion settled in 2025, against RMB 175 trillion in 2024, across 124 countries and regions (CIPS Co Ltd, reported in China Daily, March 3, 2026); 193 direct and 1,573 indirect participants as of December 31, 2025 (CIPS Participants Announcement No. 116). The dollar equivalent is roughly \$26.4 trillion at the operator's stated conversion; figures derived at other exchange-rate bases run lower. The Clearing House: CHIPS average daily settled value \$2.014 trillion in 2025, up 9 percent, across 632,419 average daily payments, with a single-day peak of \$2.97 trillion on November 28, 2025 (press release of April 7, 2026). SWIFT Global Currency Tracker, July 2026 edition (June 2026 data): renminbi share of payment value 3.10 percent, against a peak of 4.61 percent in November 2023; renminbi share of trade-finance value 8.43 percent in July 2026, second to the dollar. The renminbi fell out of the top five payment currencies in May and June 2025, its first time outside that group since May 2021 (Standard Chartered, Renminbi Globalisation Index, August 2025). Figures are on SWIFT's standard global basis including intra-eurozone flows; shares on the ex-eurozone basis differ and are not mixed here. Russian Finance Minister Anton Siluanov, speaking on Rossiya-1 around the 11th Russia-China Financial Dialogue in Beijing: 99.1 percent of Russia-China settlement carried out in rubles and yuan (TASS, November 4, 2025). This is a Russian-government claim and is not independently corroborated by Chinese official data. Bilateral trade was about \$228 billion in 2025 on China's General Administration of Customs data, down roughly 7 percent from 2024 — the first annual contraction since 2020. Project mBridge: the BIS ended its involvement on October 31, 2024, after the platform reached minimum viable product in mid-2024; the remaining participants are the central banks of China, Hong Kong, Thailand, the United Arab Emirates, and Saudi Arabia; cumulative throughput has been estimated at about \$55.5 billion across more than 4,000 transactions, some 95 percent of it in digital renminbi, by the Atlantic Council GeoEconomics Center (reported by Reuters, January 16, 2026). No participating central bank has published the figure, and the platform remains at minimum-viable-product stage rather than in production.

mid-2025 for the first time since 2021 — the opposite of the trend the avoidance story predicts. Russia-China trade, at about \$228 billion, is under one percent of global goods trade, and it contracted roughly 7 percent in 2025, the first annual decline since 2020: the flagship corridor shrank in the year the paper measures. What the infrastructure has produced is a set of bilateral corridors sized to the sanctioned parties that use them, not a substitute network; and a corridor built because the parties were sanctioned is evidence that the instrument worked, not that it is failing. The correct reading is that avoidance is real, growing, and an order of magnitude too small to have moved the dollar premium — which is what the measurement in Section 4 shows, and what would change first if this analysis were wrong.

The companion paper argued for keeping secondary sanctions on Chinese banks in reserve, treating reserve-currency depth as an asset to preserve and framing the restraint as a strategic choice.²⁸ The correct claim here is more modest than an earlier draft made: not that the choice is already becoming a necessity — that would require dollar specialness to be moving as a trend, and it is not — but that the asset being preserved has a maturity. The restraint is strategic today and becomes forced only in the conditional world where the funding decay crosses over. A strategy that treats sanctions reach as permanent is mispricing an option; the option has not yet lost value. The paper does not reach for payment-rail volumes to inflate the point, because the measured split carries it and bounds it.

6 The Objection That Adjustment Is Available

The standard reassurance is that none of this binds, because the United States can consolidate whenever it chooses: the arithmetic of stabilization is well understood, and a country that issues the reserve currency in its own denomination cannot be forced into default. The reassurance is correct on its own terms and beside the point, because it assumes the capacity whose absence is the actual problem. The tools exist. The ability to use them has been demonstrated once and then abandoned, which is worse for the reassurance than if it had never been demonstrated at all.

The magnitude is not in dispute. Stabilizing debt-to-GDP at its 2024 level requires a permanent primary-balance adjustment on the order of three percent of GDP, within a range of roughly one to five percent depending on the target, the horizon, and the assumed gap between the interest rate and growth.²⁹ A political system capable of self-correction would find that adjustment unpleasant and would make it. The record across four decades is mixed in a specific way. Gramm-Rudman-Hollings was circumvented and its enforcement mechanism struck down; Simpson-Bowles failed to reach the supermajority that would have forced a vote, and its framework was later rejected on the House floor by a margin of ten to one; the 2011 supercommittee deadlocked into an automatic sequester that both parties then spent a decade unwinding.³⁰ Those are the failures, and they span every configuration of party control.

28. “Insulate, Then Press” (WP-2026), §4, scoring secondary sanctions on China's core banking system as failing its stability constraint and noting observed restraint even where sanctions evasion is documented.

29. The 2.9-percent figure is from Alan J. Auerbach and William G. Gale, “Then and Now: A Look Back and Ahead at the Federal Budget,” NBER Working Paper 34455 (2025), summarized in *NBER Digest*, January 2026: stabilizing debt-to-GDP at its 2024 level from the current-law baseline requires permanent primary-balance changes of about 2.9 percent of GDP, roughly \$827 billion in 2024 dollars. The 0.7-to-4.6-percent range is from Furman and Summers (2024), cited above, and varies with the target level, horizon, and assumed $r - g$. The figure is stated as a magnitude without endorsing any composition of tax or spending changes.

The 1990 and 1993 agreements are not a failure and the paper does not count them as one. Together with the expansion of the 1990s they produced four consecutive surpluses, fiscal 1998 through 2001, and reduced debt held by the public by roughly sixteen points of GDP from its 1993 peak. The relevant fact is what followed: the caps and pay-as-you-go rules that enforced the adjustment were allowed to lapse, two rounds of tax reduction and a new entitlement were enacted without offsets, and the primary balance was back in deficit before the 2008 crisis added to it.³¹

Consolidation happened, it worked, and the political system reversed it as soon as it could — which establishes that the constraint is not incapacity but the absence of any mechanism that binds a future Congress to a present one.

The paper stays scrupulously agnostic on the composition of any adjustment — that agnosticism is a condition of the argument, not a hedge — because the claim is about the failure to sustain an adjustment, not about which adjustment is correct. The availability of the remedy, and the proof that it once worked, is precisely what makes its abandonment evidence of something deeper than fiscal policy, which is the subject of Section 8.

7 What Would Falsify This Assessment

The thesis is wrong under specified, observable conditions, kept distinct by whether they would refute the diagnosis or the strategy that follows from it.

The diagnosis would be substantially disconfirmed by:

- The Treasury premium recovering durably toward zero or above as debt-to-GDP rose, breaking the measured supply sensitivity — or the recovery being traceable entirely to dealer-balance-sheet relief, which would show the channel to be regulatory rather than fiscal.
- The term premium losing its sensitivity to Treasury issuance and refunding announcements, indicating the marginal buyer had gone price-insensitive again.

^{30.} Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings), as amended 1987; *Bowsher v. Synar*, 478 U.S. 714 (1986), striking the Act's enforcement mechanism (the Comptroller General's role in ordering sequestration) as a separation-of-powers violation, after which the targets were revised and then abandoned; Omnibus Budget Reconciliation Acts of 1990 (with the Budget Enforcement Act's PAYGO and discretionary caps) and 1993; National Commission on Fiscal Responsibility and Reform (Simpson-Bowles, 2010), whose final report received 11 of the 14 votes needed to trigger congressional consideration, and whose framework was subsequently offered as the Cooper-LaTourette substitute and rejected on the House floor 382–38 on March 28, 2012; Joint Select Committee on Deficit Reduction (2011), whose deadlock triggered the Budget Control Act sequester. The attempts failed, or succeeded and were reversed, under Republican, Democratic, and divided control alike.

^{31.} Unified budget surpluses of \$69 billion (FY1998), \$126 billion (FY1999), \$236 billion (FY2000), and \$128 billion (FY2001); debt held by the public fell from its 1993 peak of 47.8 percent of GDP to 31.4 percent in fiscal 2001 (Office of Management and Budget, Historical Tables). The reversal came through the Economic Growth and Tax Relief Reconciliation Act of 2001, the Jobs and Growth Tax Relief Reconciliation Act of 2003, the expiration of the Budget Enforcement Act caps and PAYGO after FY2002, and the Medicare Modernization Act of 2003, before the 2008 crisis. Julien Acalin and Laurence M. Ball, “Did the U.S. Really Grow Out of Its World War II Debt?” NBER Working Paper 31577 (2023), make the parallel point for the postwar period: debt reduction came from a sustained primary surplus and financial repression, not growth alone, and ended when the political commitment did.

- A credible primary-balance consolidation enacted, enforced by a binding mechanism, and sustained across an administration change, which would refute the self-correction claim of Sections 6 and 8.

The strategy-level claims would fail even if the diagnosis held if:

- The dollar convenience premium — the measured object, not the exchange rate — moved down with the Treasury premium across four or more consecutive quarters, the two re-merging as a trend rather than diverging as they did in April 2025, which would make the sanctions channel a current loss rather than a lagged risk and would collapse this paper's central distinction.
- An externally caused crisis arrived and the safe-haven bid absorbed the borrowing impulse at falling yields as before, showing the crisis-response capacity intact despite the decoupling.

The mid-2020s pattern — Treasury premium negative, dollar premium positive, consolidation once executed and since abandoned, one quarter of co-movement under a self-inflicted shock — is consistent with the assessment and disconfirms none of it. The assessment is falsifiable, currently unfalsified, and states the readings that would change it.

Because the falsifiers are observable, they can be operationalized as a monitoring set rather than left as abstractions. The dashboard's five series are each published on a regular cadence: net interest and revenue in the Monthly Treasury Statement and the annual CBO outlook; the official share of the foreign Treasury bid in the monthly TIC data and the annual holdings survey; the term premium daily from the New York Fed's ACM series; and the two premiums as the underlying CIP dataset is updated. The single reading that would most sharply change the assessment is the dollar premium turning down toward the Treasury premium and staying there, because that is the migration Sections 4 and 5.4 identify as the trigger converting a funding problem into a sanctions problem. A disciplined reader should track that series against the others on at least a quarterly cadence, treating any one stressed print as noise and a sustained multi-quarter move as signal. The assessment is not a one-time verdict; it is a standing hypothesis with a published scorecard, and it should be revisited as the scorecard prints.

8 Two Powers, One Constraint

The companion paper diagnosed a China that cannot rebalance its economy toward household consumption because the required transfer of income and authority threatens the growth coalition on which the party's control rests — a diagnosis it shares with the standard rebalancing literature and does not originate.³² This paper diagnoses a United States that cannot sustain a fiscal consolidation because the required imposition of concentrated present costs threatens whichever electoral coalition attempts it, and because no mechanism exists to bind the coalition that follows. The symmetry is the payload, and it must be stated carefully, because the easy version of it is wrong.

The pathologies are not identical. Their machinery is opposite. China fails through the concentration of authority: a system that can act decisively cannot afford the specific action rebalancing requires, because

that action redistributes power away from the center. The United States fails through the dispersion of authority: a system built to prevent concentrated action cannot hold the coalition consolidation requires, because veto points and electoral horizons make diffuse-future-benefit, concentrated-present-cost policies unpassable in most years and unsustainable in the rest. One cannot act against its own structure; the other can act, has acted, and cannot keep the action in place. To call these the same disease is to miss what each reveals.

What they share is narrower and more important than a common pathology, and it is neither a common machinery nor a vacuous “internal constraint”: both face a known, diagnosed, solvable problem that goes unsolved because the solution would require the political economy to act against its own organizing principle. That is the whole of the symmetry, and it is enough. The companion paper argued that China's decline is close to automatic because its constraint is structural and unreformable on any timeline that matters. This paper argues that American decline is not automatic — the constraint is self-imposed, has been relaxed once within living memory, and could be relaxed again by a political system that recovered the capacity to bind itself — which is exactly why the failure to relax it is the more damning.

China's constraint is a fate. America's is a choice, and the fiscal path is where the choice is being made by default, in full view of the arithmetic, with no adversary requiring it.

9 Conclusion

Fiscal position is a strategic asset, and the United States is spending it down without deciding to. The funding privilege that underwrites deterrence, crisis response, and industrial policy has measurably decayed — the Treasury premium has been negative since 2021 through a channel that runs on the quantity of debt issued, interest outlays have exceeded defense since fiscal 2024 and are projected to double against it, the interest–growth gap that made 2020's borrowing free has narrowed to the point where it may turn against the debt within the projection window, and the marginal buyer of the debt, foreign and domestic, charges for absorbing supply as the marginal buyer of a decade ago did not. The dollar privilege that underwrites sanctions reach is intact, which is why the sanctions channel is a lagged risk rather than a present loss, and why the honest form of the argument is narrow: the funding instruments of American power are under measured pressure, the sanctions instrument is exposed to a conditional future whose mechanism April 2025 briefly displayed, and the threshold that separates a budgeting problem from a strategic one is approached on the Treasury side and not yet crossed on the dollar side.

The companion paper held that American success depends less on what the United States does to China than on whether it preserves its own advantages. The fiscal case is the sharpest demonstration of that claim, because it is the one where the adversary is entirely absent, the remedy is entirely known, and the

32. Michael Pettis, *The Great Rebalancing* (Princeton, 2013), and subsequent Carnegie commentary; Rhodium Group, annual assessments of China's household-consumption share and local-government fiscal position. The companion paper carries the argument; it is cited here only to locate it.

remedy has already been applied once and worked. China's decline is a fate its political economy imposes on it. American decline, in this domain, is a choice its political economy is making by not choosing, and by unchoosing when it has chosen. That is the whole of the asymmetry, tested where it is cleanest: the competitor does not have to win. The United States can lose without being beaten, and on the fiscal path it is doing so in full view of the numbers that would tell it how to stop.

APPENDIX A

The dashboard, plotted

The two figures below plot the dashboard rows for which published data permit it. The remaining three rows are reported in Section 4.3 and their sources are listed at the end of this appendix so that any reader can rebuild the whole set.³³

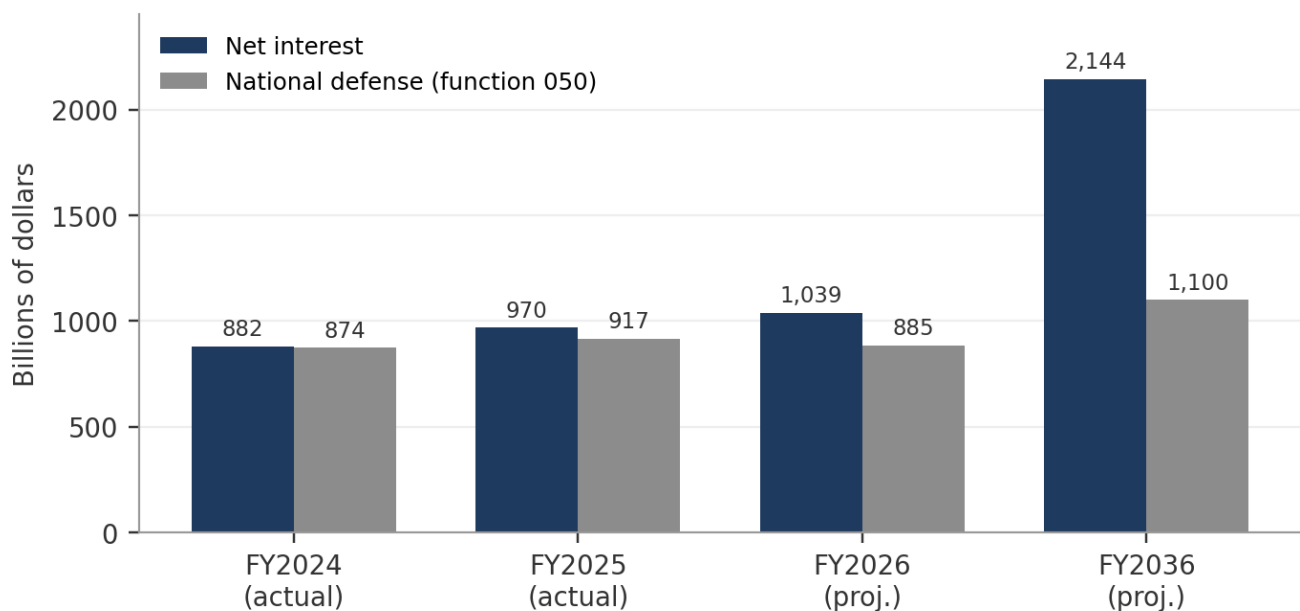


Figure A1. Net interest and national defense outlays, actuals and CBO projections. The crossover is an accomplished fact, not a forecast: net interest passed national defense in fiscal 2024 and the gap has widened in every year since. The projected ratio in 2036 is close to two to one.

³³. Figure A1 draws on Congressional Budget Office, publication 61882 (February 2026), and on FY2024 and FY2025 actuals from the Monthly Treasury Statement; defense is budget function 050 in all four years. Figure A2 reports the period averages published in Du, Keerati, and Schreger (2025); the underlying series is a covered-interest-parity construction from the Du-Im-Schreger dataset, and year-by-year values are not separately published, so only period averages are plotted. The trigger line is the author's, not the authors'.

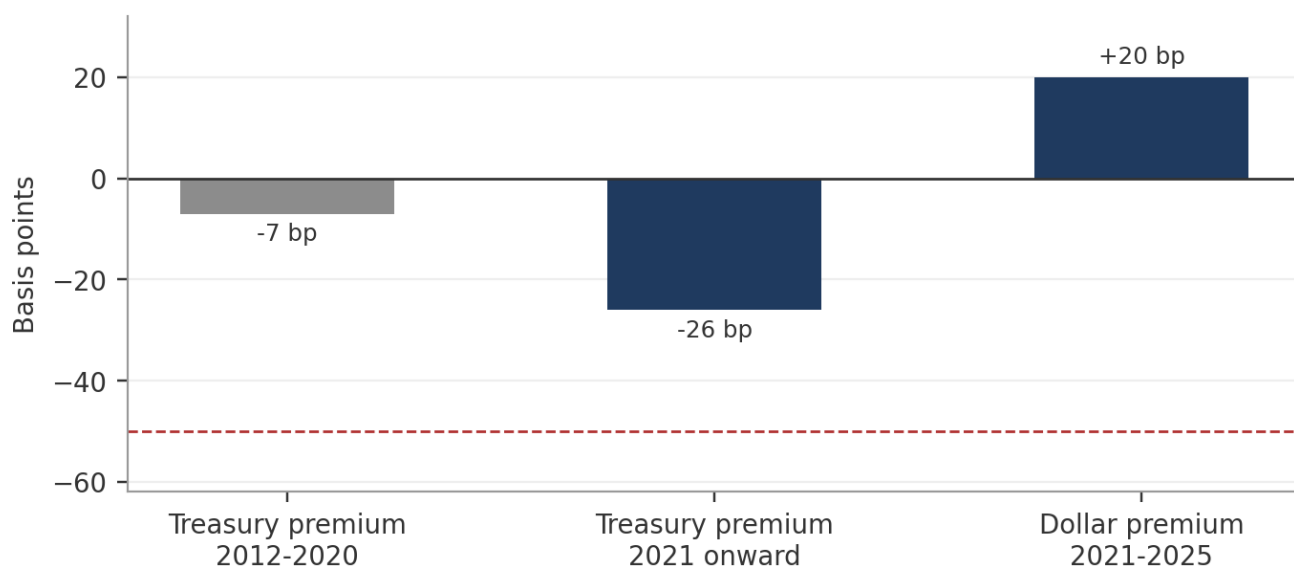


Figure A2. Treasury and dollar premiums, period averages. The decoupling in one image: the Treasury premium fell from marginally negative to substantially negative after 2021, while the dollar premium stayed positive. The dashed line is the trigger stated in Section 4.3, not a threshold from the literature.

The monitoring set in Section 7 is reproducible from public sources on the cadence below. Nothing in this paper rests on proprietary data.

Series	Source	Cadence	Latest used here
Net interest, revenues, defense (050)	CBO <i>Budget and Economic Outlook</i> (pub. 61882) and <i>Monthly Budget Review</i> ; Monthly Treasury Statement	Monthly / annual	FY2025 actual; Feb. 2026 projection
Official share of foreign Treasury holdings	Treasury TIC annual survey (shl2025r) and Major Foreign Holders Table 5; CRS RS22331	Monthly / annual	Dec. 2025 (survey); June 2026 (MFH)
10-year term premium	NY Fed Adrian–Crump–Moench series (ACMTP10)	Daily	Aug. 2026
Treasury and dollar premiums	Du–Keerati–Schreger (2025); Du–Im–Schreger CIP dataset	Periodic	2021–2025 averages
Reserve shares	IMF COFER data brief	Quarterly	2026Q1

SOURCES

A note on sources

Fiscal magnitudes are drawn from the Congressional Budget Office's *Budget and Economic Outlook: 2026 to 2036* (publication 61882, February 2026) and Monthly Budget Reviews; reserve and holdings data from the IMF's COFER release

(2026Q1) and the Treasury International Capital system, and external-account data from the Bureau of Economic Analysis, with the annual benchmark survey and the monthly custodial table kept distinct; the convenience-yield decoupling from Du, Keerati, and Schreger, NBER Working Paper 35000 / Federal Reserve IFDP 1427 (2025–2026), read against Du, Im, and Schreger (2018) and Krishnamurthy and Vissing-Jorgensen (2012); the interest–growth framework from Blanchard (2019) and Furman and Summers (2024); the stabilization magnitude from Auerbach and Gale (NBER Working Paper 34455) and from Furman and Summers; the sanctions mechanism from Farrell and Newman (2019) and the geoeconomics literature; and the industrial-policy costs from Congressional Research Service data and Department of Defense and company disclosures on the 2025 rare-earths partnership. Framing draws on the exorbitant-privilege literature — Eichengreen; Gourinchas and Rey; Farhi and Maggiori — and, for fiscal dominance, on Sargent and Wallace and on Leeper.³⁴

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³⁴. Barry Eichengreen, *Exorbitant Privilege* (Oxford, 2011); Pierre-Olivier Gourinchas and Hélène Rey, “From World Banker to World Venture Capitalist: U.S. External Adjustment and the Exorbitant Privilege,” in Richard H. Clarida, ed., *G7 Current Account Imbalances: Sustainability and Adjustment* (University of Chicago Press for NBER, 2007): 11–66; Emmanuel Farhi and Matteo Maggiori, “A Model of the International Monetary System,” *Quarterly Journal of Economics* 133(1) (2018): 295–355; Javier Bianchi, Saki Bigio, and Charles Engel, “Scrambling for Dollars: International Liquidity, Banks and Exchange Rates,” NBER Working Paper 29457 (2021). On fiscal dominance specifically: Thomas J. Sargent and Neil Wallace, “Some Unpleasant Monetarist Arithmetic,” *Federal Reserve Bank of Minneapolis Quarterly Review* 5(3) (1981); Eric M. Leeper, “Equilibria under ‘Active’ and ‘Passive’ Monetary and Fiscal Policies,” *Journal of Monetary Economics* 27(1) (1991): 129–147. John H. Cochrane, *The Fiscal Theory of the Price Level* (Princeton, 2023), is the general treatment and is not the source for the dominance concept.