The U.S. dollar, as we know it today, was born in terror. On April 18, 1906, the Pacific tectonic plate, which extends under the ocean from Japan to central California, darted northward about 20 feet in just under a minute; in San Francisco, buildings that were not shattered by the earthquake burned, and within two days, 80 percent of the city was gone. At the time, American companies and governments still bought insurance from the old British firms, and the payouts to San Francisco were enormous. As was standard practice, the insurers paid in gold, shipping $65 million worth of bars — an estimated 107 tons, representing 14 percent of all British gold reserves — to the Bay Area. Afraid that all that gold leaving its vaults would permanently impoverish the kingdom, the Bank of England doubled interest rates on British bonds. In response, so many wealthy Americans sent money to England that, a few months after the gold came west from London, $30 million in U.S. gold traveled east. The British vaults were replenished, while the U.S. stock fell by 10 percent in two months.

Back then, dollar bills were printed by local banks, not the government, and each bill was a claim on the actual gold sitting in a specific bank’s vault. With all that gold hurtling to and fro, many Americans grew suspicious that their banks no longer had enough. There were runs, and dozens of financial institutions failed in what was the country’s worst financial panic to that point — which is saying quite a bit, because the country had weathered major financial crises every generation since its founding. It took the nation’s most powerful banker, J. P. Morgan, to resolve the crisis. Summoning the treasury secretary to his home on 36th Street, he explained that the government and a consortium of bankers would bail out the system by, among other things, bringing $36 million in gold to New York City. (The Times, in a November 1907 headline, referred to him as “A Bank in Human Form”; the article described him as “moving the pieces on the financial chess board at will, whether they were
kings or pawns.”) Americans thought their economic lives were built on a solid foundation of gold. Now, suddenly, they learned that the only thing of enduring value was the will of one rich man.

To ensure this would never happen again, Congress created a new entity, the Federal Reserve System, whose experts would manage the value of the dollar by setting key interest rates. That system worked far better than anybody imagined it would. Few people then — and few people now — could actually describe what it is that the Fed does (in a poll in late 2014, fewer than 24 percent of Americans could pick Janet Yellen as the current head of the Fed from a list of four names, less than would be expected by pure chance). But somehow we have come to accept that the invisible panel of experts, with their confusing statements about interest rates, knows what it is doing. The dollar has performed remarkably well under their power, and indeed the Fed is a part of the reason the United States became the dominant global economy in the 20th century. Before its creation, many bet on Argentina as the major new world economy. I remember a professor of the history of religion once saying that global confidence in the dollar is the greatest example of collective faith in an abstract symbol in human history. The dollar, under the Fed, has achieved something no god, no prophet, no messiah has been able to do.

It would have been understandable if faith in the dollar had wavered after the financial crisis of 2008. After all, the crisis began in the United States, at least in part as a result of bad Fed policy. For well over a year, the Fed was constantly behind, delivering obtuse assertions of health about a financial system that was collapsing. But the dollar itself never faltered. Confidence in currencies is measured in various ways — by inflation, by the interest rate governments have to pay to borrow, by the exchange rate with other currencies and so on. For years now, the dollar has performed better than at almost any point in history on all of these measures. Seven years after a U.S. financial crisis nearly brought down the world economy, confidence in the dollar has never been stronger.

The modern dollar was born because Americans wanted control over their own economic destiny. But now the rest of the world is at our whims. I spoke with Inan Demir, chief economist of Turkey’s Finansbank. He told me that Janet Yellen has the ability to influence Turkey’s economy more than Turkey’s own central bank or its president. In 2011 and 2012, with its “quantitative easing” program, the Fed created tens of billions of new dollars each month. Enough of those dollars flowed to Turkey
that the economy there grew by around 9 percent for two years. “That’s China levels,” Demir pointed out. In 2013, when Ben Bernanke, then the Fed chairman, announced that the Fed would stop making all those new dollars, the Turkish stock market fell by a third and hundreds of thousands of Turks lost their jobs. The story is similar in South Africa, Hungary, Indonesia, Brazil, Lebanon and many other emerging markets, where economic policy makers and corporate executives anxiously await Yellen’s every word.

Paradoxically, this universal confidence in the dollar is not necessarily good for our economy. Since 1977, the leader of the Fed has had two legal mandates: to keep the dollar’s value stable and to maximize employment. Yellen is doing the first part of her job so well — so much better, in fact, than anyone could have expected — that she’s hampering the second part, the one about more of us having decent jobs. Corporations, as a group, are now net savers, with an estimated $659 billion in the bank, an enormous shift from historic norms. Entrepreneurship is flat; the percentage of Americans starting new businesses is near a 20-year low. Venture capital, often seen as the most vibrant part of our economy, collapsed in 2000 and has barely budged upward since. In the language of finance, the world’s money is crammed at the safest part of the risk curve. This is bad, because further out on the curve, in the riskier precincts, is where new ideas and new businesses are created.

Discussing this problem with Adam Posen, who once helped set rates at the Bank of England, I joked that Yellen’s job would be solved by simply pouring anti-anxiety drugs into the U.S. water supply, giving people the confidence to make more risky investments in the future. Barring that, Posen pointed out, there is another option. Yellen needs to make people feel a bit more afraid of what she might do.

It wouldn’t take much. If she were persuaded to state that, for example, inflation “slightly” above the long-term target of 2 percent may be acceptable, or even a hint along those lines, she would shock global markets. Fearing their piles of dollars would lose value, many investors would accept that they had to put their money in riskier ventures if they had any hope of outearning rising inflation. Yellen could most likely manage the reaction with the careful use of adjectives. If there weren’t strong enough investor response, she could substitute “a bit” for the word “slightly” in her next statement. If there’s too strong a reaction, she need say only “very slightly” the next time. The Federal Reserve, charged with overseeing the trustworthiness of the
dollar, might need to instruct the world to trust the dollar less.

**Before the 2008 crisis, I** believed, without thinking too much about it, that there was something solid at the core of our financial system. I imagined the world was governed by math — or, more specifically, by serious men in dark suits who understood the complex formulas playing out in their Bloomberg terminals. I, sadly, wasn’t alone. An embarrassingly strong faith in math and models led so many people around the world to create, buy and underregulate securities that were, in hindsight, built not on mathematical laws but on an ugly combination of fraud and naïveté. For me and many others who watch the markets, the collapse was not just a horrible financial and economic disaster. It was also a psychological and existential blow. It brought on a painful recognition that there is nothing truly solid at the center of our economic lives. There are only the stories we tell one another, the promises we make, the shared views we have about the future. It’s something like the challenge so many writers faced in the late 19th and early 20th centuries, when they confronted a world without a knowable God providing absolute structure. Or the work by Einstein and Heisenberg that shattered the predictable world of Newton and showed that there will always be uncertainty, that there are fundamental limits to our understanding.

Economics did have its own analog to those thinkers. In 1921, Frank Knight, an economist at the University of Chicago, wrote a powerful paper that differentiated risk from uncertainty. The word “risk,” he argued, should apply to phenomena that can be modeled mathematically. But “uncertainty,” he said, is something else altogether: It is the deep unknown. Predicting where the stock market will be in a week or a month or a decade is risk. We might disagree on the number, but we agree on the basic data and measuring tools. Uncertainty describes those things we can’t begin to measure and don’t even know exist. (Strikingly, Knight introduced his version of uncertainty six years before Werner Heisenberg applied that word to the movement of atoms.)

Every economist has been trained in this Knightian distinction. But Knight didn’t transform his field in the way Einstein and Heisenberg changed theirs. The financial crisis came about because people believed they were in a world of risk — where the chance of default on mortgages and more complex derivatives can be plotted with great precision — when instead there was deep uncertainty afoot.

After the crash, it seemed, for a moment, as if finance might finally internalize this lesson, accepting that too much certainty, too much faith, can be violently
destructive. Instead, though, the global economy simply grabbed onto the surest thing it could. That turned out to be the U.S. dollar.

In the future, perhaps, finance will come to terms with the fact that the dollar is not the sure thing at the center. Nothing is. And if we let go of faith in the dollar, just a little bit, if we embrace the fact that the world is more mysterious and chaotic than we could imagine, then we might find — like artists and physicists have — that a world without certainty can be richer, in all senses of that word, than a world with false convictions.

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