The Hollow Core Hypothesis: Systemic Risk, Sovereign Balance Sheets, and Perceptions of Structural Fragility in the Global Financial System

lockekdauch April 18, 2026

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Date: April 2026
Document Type: Working Paper / Case-Linked Structural Analysis
Target Journal Format: General (Elsevier / Springer / Taylor & Francis compliant)

Author's Note

This paper combines publicly available macro-financial data with an anonymized qualitative case study. All personal identifiers have been removed. The case study is presented as an interpretive lens rather than dispositive evidence. Supporting documentation is retained by the author and available to appropriate authorities upon request.

No confidential or proprietary data is included. The macro-financial data cited are derived from publicly accessible reports by the Bank for International Settlements (BIS), International Monetary Fund (IMF), United States Treasury, Government Accountability Office (GAO), Securities and Exchange Commission (SEC), and related institutions.

Abstract

This paper examines whether recent developments in global finance—elevated over-the-counter (OTC) derivatives exposure, pandemic-era fiscal expansion, sovereign balance sheet deterioration, and gradual reserve diversification—can be interpreted as indicators of structural fragility in the contemporary monetary system.

Drawing on data from the BIS, IMF, U.S. Treasury, and related institutions, the paper advances a **hypothesis of systemic strain**, characterized by an increasing gap between nominal financial claims and underlying real-economy capacity. A secondary contribution is an anonymized case study illustrating how perceived institutional inaccessibility at the individual level may mirror broader concerns about legal and financial system responsiveness.

The paper does not assert imminent collapse. Rather, it argues that **confidence-dependent systems exhibit nonlinear risk when opacity, leverage, and institutional constraints converge**. The central contribution is a framework for interpreting systemic fragility as a hypothesis requiring further empirical testing, not a settled conclusion.

Keywords: systemic risk, OTC derivatives, sovereign balance sheets, de-dollarisation, reserve diversification, pandemic fraud, synthetic equity, Bretton Woods III, financial fragility, access to justice, confidence-dependent systems, nonlinear risk

JEL Classification: G01, G15, G18, H12, H63, K22, N20

1. Introduction

Since the 2008–2009 global financial crisis, advanced economies have relied on a combination of monetary expansion, fiscal intervention, and regulatory stabilization to maintain systemic continuity (Bernanke, 2010). A similar policy pattern was observed during the COVID-19 pandemic, though at significantly larger scale (International Monetary Fund [IMF], 2021).

Recent data points have prompted renewed debate regarding systemic resilience:

Indicator	Observed Trend	Source
Global OTC derivatives notional value	Hundreds of trillions USD	BIS, 2025
U.S. federal net position (assets minus liabilities)	Negative $41.7 trillion	U.S. Treasury, 2025
U.S. dollar share of global reserves	Declined from >70% (2000) to 56.9% (2025)	IMF COFER, 2025
Pandemic fraud estimates (U.S. only)	Hundreds of billions to $1 trillion	GAO, 2023; DOJ, 2023

This paper frames these developments not as isolated phenomena but as **interrelated features of a highly financialized system dependent on confidence, liquidity, and institutional credibility**. The central research question is not whether the system will collapse—a claim this paper does not make—but whether current conditions are consistent with a **hypothesis of increasing structural fragility**.

The paper proceeds as follows. Section 2 examines synthetic equity events as market stress indicators. Section 3 analyzes OTC derivatives exposure. Section 4 reviews pandemic-era fiscal expansion and fraud estimates. Section 5 discusses sovereign balance sheet interpretations. Section 6 examines reserve diversification. Section 7 considers institutional frameworks and the absence of systemic reset. Section 8 addresses geopolitical risk. Section 9 presents an anonymized case study. Section 10 synthesizes findings. Section 11 concludes with research limitations and future directions.

2. Synthetic Equity Events as Market Stress Indicators

The 2021 volatility episodes involving GameStop (GME) and AMC Entertainment Holdings Inc. highlighted structural tensions in equity market plumbing. The U.S. Securities and Exchange Commission (SEC, 2021) concluded that:

- Extreme price movements were driven by a combination of short covering and retail participation;
- Market structure features, including payment for order flow and internalization, contributed to volatility.

While claims of widespread “synthetic shares” or naked short selling remain contested in the academic literature (SEC, 2021; FINRA, 2021), the episode raised **legitimate, unanswered questions regarding transparency, settlement timelines, and short exposure reporting** (Posen & Trivedi, 2021; Fox, 2022).

Interpretive claim (hypothesis): Rather than definitive evidence of systemic fraud—a claim this paper does not make—these events may be better understood as **stress tests revealing opacity in market infrastructure**. Whether such opacity constitutes a systemic vulnerability is an empirical question requiring further regulatory disclosure.

3. The OTC Derivatives Market and Systemic Exposure

According to the Bank for International Settlements (BIS, 2025), global OTC derivatives notional value remains in the hundreds of trillions of dollars. Key characteristics include:

- High notional values relative to global GDP (approximately seven times);
- Concentration among a small number of major financial institutions;
- Continued reliance on bilateral contracts in certain segments (e.g., credit default swaps, foreign exchange forwards).

3.1 Notional vs. Net Exposure

Importantly, notional value is not equivalent to actual economic exposure. Netting agreements and collateralization practices significantly reduce realized counterparty risk (BIS, 2023; Duffie, 2020). However, historical precedents—most notably the 2008 financial crisis—demonstrate that **counterparty risk and liquidity shocks can amplify systemic stress under adverse conditions** (Brunnermeier, 2009; Gorton, 2010).

3.2 Concentration and Opacity

The BIS Quarterly Review (December 2025) explicitly identified vulnerabilities similar to those preceding 2008: hidden leverage, counterparty concentration, and opacity in certain OTC segments (BIS, 2025). The IMF's April 2026 Global Financial Stability Report stated that "global financial stability risks remain elevated," driven by Middle East conflict and persistent tight financial conditions (IMF, 2026).

Interpretive claim (hypothesis): The combination of high notional exposure, concentration, and opacity suggests a **potential vulnerability surface** that could, under specific shock conditions, propagate stress across the financial system. Whether such propagation would result in systemic collapse is not predicted; rather, the paper identifies this as a risk concentration requiring continued monitoring.

4. Pandemic Fiscal Expansion and Fraud Risk

The United States authorized approximately $5 trillion in pandemic-related fiscal measures between 2020 and 2021, including the CARES Act, Consolidated Appropriations Act, and American Rescue Plan Act (U.S. Government Accountability Office [GAO], 2021; Congressional Research Service [CRS], 2021).

4.1 Fraud Estimates

Subsequent government watchdog and academic estimates suggest substantial fraud losses. The GAO (2023) reported that fraud in pandemic relief programs—including the Paycheck Protection Program (PPP) and unemployment insurance—amounted to hundreds of billions of dollars. The U.S. Department of Justice (DOJ, 2023) has prosecuted thousands of fraud cases. Some academic estimates place total fraud as high as $1 trillion (SSRN, 2024), though such figures remain contested.

4.2 The Speed-Oversight Trade-Off

This pattern reflects a broader trade-off inherent in crisis-response frameworks:

Priority	Trade-Off
Rapid liquidity provision	Reduced front-end oversight
Minimizing economic collapse	Increased fraud exposure

Rather than an anomaly, this dynamic is consistent with crisis-response frameworks that prioritize rapid stabilization over ex ante fraud prevention (Tooze, 2021; Philippon, 2019). Whether the fraud losses represent a tolerable cost of crisis response or a systemic failure of accountability is a normative question beyond this paper's scope.

5. Sovereign Balance Sheets and Interpretations of Insolvency

The United States Department of the Treasury (2025) reports a negative net position when long-term obligations are included in its Fiscal Year 2025 Financial Report:

Line Item	Amount (USD)
Total Assets	$6.06 trillion
Total Liabilities	$47.78 trillion
Net Position	**–$41.7 trillion**

5.1 The Sovereign Insolvency Interpretation Problem

Applying private-sector insolvency frameworks to sovereigns is analytically limited for several reasons (Reinhart & Rogoff, 2009; Rogoff, 2016):

- Sovereigns control taxation and currency issuance;
- Debt sustainability depends on growth, interest rates, and market confidence—not balance sheet identity alone;

- No global sovereign bankruptcy court exists to enforce private-sector insolvency procedures.

Scholars such as Rogoff (2016) emphasize that sovereign distress is typically **liquidity- and confidence-driven**, rather than accounting-based. The U.S. government's ability to service its debt in its own currency—while not infinite—differs fundamentally from a private corporation's inability to pay.

5.2 Structural Fiscal Pressure

Nevertheless, the negative net position indicates **structural fiscal pressure**. The federal government spends approximately 25% of total revenue on debt interest—a figure that would escalate under higher interest rates or failed debt rollover (Congressional Budget Office [CBO], 2025). Whether this pressure constitutes an imminent crisis or a manageable long-term challenge is contested in the literature (Blanchard, 2019; Summers, 2020).

Interpretive claim (hypothesis): The U.S. Treasury's balance sheet, while not evidence of imminent default, is consistent with a **hypothesis of increasing fiscal fragility**—defined as reduced capacity to absorb future shocks without significant policy adjustment or market disruption.

6. Reserve Diversification and Monetary Evolution

Data from the IMF's Currency Composition of Official Foreign Exchange Reserves (COFER) database indicate a gradual decline in the U.S. dollar's share of global reserves (IMF, 2025):

Year	Dollar Share
2000	>70%
2025	56.9%

6.1 Drivers of Diversification

This trend reflects multiple factors (Arslanalp & Eichengreen, 2023; Chinn & Frankel, 2020):

- Portfolio diversification by central banks;
- Growth of alternative currencies (e.g., Chinese renminbi, euro);
- Increased geopolitical fragmentation and sanctions risk.

6.2 Dollar Dominance Remains

However, the dollar remains dominant due to structural advantages:

Advantage	Explanation
Deep capital markets	Unmatched liquidity and instrument variety
Institutional stability	Rule of law, property rights, monetary credibility
Network effects	Invoicing, settlement, and reserve habits are self-reinforcing

Thus, current trends suggest **evolution rather than abrupt displacement**. Whether de-dollarisation will accelerate or plateau is an empirical question dependent on future policy and geopolitical developments (Farhi & Maggiori, 2018; Eichengreen, 2011).

Interpretive claim (hypothesis): The gradual decline in dollar reserve share, while not evidence of imminent dollar collapse, is consistent with a **hypothesis of long-term monetary fragmentation**—a multi-polar reserve system rather than a dollar-dominated one.

7. Institutional Frameworks and the Absence of Systemic Reset

Since the end of the Bretton Woods system (1971–1973), no comprehensive redesign of global monetary architecture has occurred. The 1944 Bretton Woods conference created the IMF, World Bank, and dollar-gold peg (Bordo & Eichengreen, 1993). The post-1971 system has been described as “Bretton Woods II” (Dooley, Folkerts-Landau, & Garber, 2003)—an informal arrangement centered on dollar reserve accumulation by emerging economies.

7.1 Bretton Woods III: Theoretical but Not Actual

Academic and policy discourse has proposed “Bretton Woods III”—a digital, multi-polar, or commodity-backed system (Arslanalp & Eichengreen, 2023; Peterson Institute for International Economics [PIIE], 2024). However, no treaty has been signed, no summit has been convened, and no roadmap has been adopted. The concept remains theoretical.

7.2 Institutional Obsolescence Concerns

The IMF and World Bank are widely criticized as “outdated, inequitable, and misaligned” with contemporary global challenges (United Nations Conference on Trade and Development [UNCTAD], 2025; Stiglitz, 2017). There is no mechanism to restructure the estimated $100+ trillion in global public and private debt, no framework for a post-dollar world, and no political consensus to create one (UNCTAD, 2025).

Interpretive claim (hypothesis): The absence of a unified reform framework suggests that **systemic adjustment is occurring incrementally and reactively** rather than through planned institutional redesign. Whether this incrementalism constitutes a vulnerability or a stability feature is contested in the literature (Tooze, 2018; Rodrik, 2011).

8. Geopolitical Risk and Financial Stability

Conflicts such as those involving Ukraine and Iran have measurable economic impacts (World Bank, 2025; OECD, 2025; IMF, 2025):

Impact	Mechanism
Inflationary pressures	Commodity price shocks, supply chain disruption
Commodity volatility	Energy and food price spikes
Fiscal strain	Increased military spending, refugee costs

8.1 The Distraction Hypothesis

Some analysts argue that geopolitical events can shift attention away from financial vulnerabilities. However, such claims are best framed as **interpretive perspectives rather than causal conclusions**. The academic literature on crisis-induced distraction is limited and contested (Chomsky, 2016; Hedges, 2015; Mueller, 2021).

Interpretive claim (hypothesis): Geopolitical conflicts, while primarily humanitarian and strategic crises, may incidentally affect financial risk perception. Whether such incidental effects constitute a deliberate “pressure valve” function is a claim this paper does not make, lacking causal evidence.

9. Case Study: Perceived Institutional Inaccessibility

An anonymized qualitative case study documents an individual’s attempts to secure legal representation across multiple jurisdictions following an alleged transnational extraction event. The case is presented as **illustrative of potential access-to-justice barriers**, not as dispositive evidence of systemic conspiracy.

9.1 Observed Outcomes

The individual reported:

- High rates of non-engagement by legal firms contacted;
- Rapid rejection without detailed case review;
- Limited substantive consultation despite documented evidence.

9.2 Possible Interpretations

Possible interpretations of these observations include, but are not limited to:

Interpretation	Explanation
Conflict-of-interest constraints	Firms may have pre-existing relationships with adverse parties
Risk aversion in complex disputes	Cross-border cases present jurisdictional and enforcement uncertainty
Resource allocation decisions	Firms prioritize higher-probability, lower-complexity matters
Evidence credibility thresholds	Initial screening may have underestimated evidentiary value

9.3 Limitations

The case study has significant limitations: it is single-subject, not generalizable, and relies on self-reported data. It does not independently establish coordinated misconduct, systemic capture, or institutional failure.

9.4 Contribution

Nevertheless, the case highlights **the importance of access-to-justice considerations in transnational disputes**. Whether the observed pattern reflects systemic barriers or idiosyncratic factors is an empirical question requiring further research. The case is presented to ground the paper's structural analysis in lived experience, not to prove a causal claim.

10. Synthesis: Interpreting Systemic Fragility

Across the domains examined, several themes recur:

Domain	Observed Feature	Interpretation (Hypothesis)
Derivatives	High notional exposure, concentration, opacity	Leverage concentration risk
Fiscal policy	Large-scale stimulus with substantial fraud	Liquidity prioritization trade-off
Sovereign finance	Negative net position	Structural fiscal pressure
Currency system	Gradual reserve diversification	Long-term monetary fragmentation
Legal access	Representation barriers in transnational cases	Institutional friction / access-to-justice gaps
Geopolitics	Conflicts with measurable economic impacts	Risk perception effects (not causal)
Institutional reform	No new Bretton Woods	Reactive, incremental adjustment

Taken together, these observations **do not conclusively demonstrate systemic failure**. However, they support a **coherent hypothesis of increasing complexity, opacity, and dependency on confidence mechanisms** (Minsky, 1986; Kindleberger, 1978; Reinhart & Rogoff, 2009).

10.1 The Confidence-Dependency Thesis

Confidence-dependent systems—whether financial markets, currency regimes, or legal institutions—exhibit nonlinear risk dynamics (Glaeser, 2017; Shiller, 2019). When opacity, leverage, and institutional constraints converge, small shocks can produce disproportionate outcomes (Goldin & Mariathasan, 2014; Haldane, 2009).

This paper does not predict such an outcome. It proposes that **current conditions are consistent with elevated fragility**, and that further empirical research is warranted.

11. Conclusion

11.1 Summary of Findings

The contemporary global financial system is best understood as:

- Highly interconnected;
- Confidence-dependent;
- Structurally resilient but not invulnerable.

Rather than predicting collapse, this paper emphasizes:

Priority	Rationale
Transparency	Reduces opacity-driven risk
Institutional credibility	Sustains confidence mechanisms
Fragility monitoring	Identifies vulnerability surfaces before shocks

11.2 Research Limitations

This paper has several limitations:

- Reliance on publicly available macro-data without primary data collection;
- Single-subject case study not generalizable;
- Hypotheses framed as interpretive claims, not tested empirically;
- Geopolitical analysis limited by causal identification challenges.

11.3 Future Research Directions

Future research should focus on:

- Cross-market contagion pathways under stress scenarios;
- Legal system accessibility in transnational disputes (quantitative studies);
- The interaction between financial complexity and public trust (survey and experimental methods);
- Empirical testing of the “systemic strain hypothesis” using time-series and panel data.

11.4 Closing Reflection

The system’s resilience has been tested repeatedly since 2008. Each test has revealed different vulnerabilities. Whether the next test will produce adaptation or fracture is not knowable in advance. What is knowable is that **confidence, transparency, and institutional responsiveness are not optional features of stable systems—they are structural requirements**.

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Acknowledgements (Optional for Submission)

The author acknowledges the Sovereign Integrity Institute (SII) for institutional support. The case study participant provided informed consent for anonymized academic use. No external funding was received.

Conflict of Interest Statement

The author declares no financial conflict of interest. The author is the subject of the anonymized case study, which is disclosed transparently in the Author's Note and Section 9.

Data Availability Statement

All macro-financial data cited are publicly available from the BIS, IMF, U.S. Treasury, GAO, SEC, and other cited sources. The anonymized case study documentation is retained by the author and not publicly available to protect participant confidentiality.

Citation: Anonymized (2026). The Hollow Core Hypothesis: Systemic Risk, Sovereign Balance Sheets, and Perceptions of Structural Fragility in the Global Financial System. *SII Working Paper Series*, 2026(14). (Anonymized case study).

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